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IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

EXXON CORPORATION,
Petitioner,

v.

DEPARTMENT OF ENERGY, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE TEMPORARY EMERGENCY COURT OF APPEALS OF THE UNITED STATES

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QUESTIONS PRESENTED

1. Even though the defendant presented no evidence of either inexcusable delay or prejudice and the district court rejected the defense of laches on cross-motions for summary judgment, may the court of appeals simply announce its belief that the defendant was prejudiced by delay and reverse on the ground that the plaintiff's suit therefore was out of time?

2. May a court of appeals, in applying the doctrine of laches, disregard both the precept that pleadings are to be liberally construed and the rule that an amended pleading relates back to the date of the original pleading?

3. May a suit for declaratory judgment on the validity of a federal regulation be barred by laches even though the regulation's invalidity is a defense to a pending enforcement action that the government brought against the plaintiff after the plaintiff's own suit was filed? *

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* The parties in the court of appeals were plaintiffs Exxon Corporation and Texaco Inc. and defendants United States Department of Energy and Donald P. Hodel, Secretary of Energy. Petitioner Exxon Corporation hereby adopts and incorporates, to the extent applicable, the questions presented by Texaco Inc. in its separate petition for a writ of certiorari.

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DEPARTMENT OF ENERGY, *et al.*,

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PETITION FOR A WRIT OF CERTIORARI TO THE TEMPORARY EMERGENCY COURT OF APPEALS OF THE UNITED STATES

Exxon Corporation ("Exxon") hereby petitions for a writ of certiorari to the Temporary Emergency Court of Appeals of the United States ("TECA") in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. A) is not yet reported. The opinions of the United States District Court for the Northern District of Texas (App. B and App. C) are reported at 582 F. Supp. 911 and 582 F. Supp. 927.[1]

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[1] In its second opinion, the district court certified to TECA certain constitutional issues arising under *Immigration & Naturalization Service v. Chadha*, 462 U.S. 919 (1983). TECA dealt with those issues separately, and they are not presented here. *See Exxon Corporation v. Department of Energy*, 744 F.2d 98 (TECA 1984), *cert. denied*, 53 U.S.L.W. 3418 (Dec. 3, 1984).

JURISDICTION

The judgment of the court of appeals was entered on December 17, 1984. This Court's jurisdiction is invoked under section 211(g) of the Economic Stabilization Act of 1970 ("ESA"), *as amended*, 12 U.S.C. § 1904 note, as incorporated by section 5(a)(1) of the Emergency Petroleum Allocation Act of 1973, Pub. L. No. 93-159, 87 Stat. 627, 633.

RULES AND REGULATION INVOLVED

Fed. R. Civ. P. 8(f) provides:

> All pleadings shall be so construed as to do substantial justice.

Fed. R. Civ. P. 15(a) and (c) in pertinent part provide:

> (a) A party may amend his pleading once as a matter of course at any time before a responsive pleading is served . . . . Otherwise a party may amend his pleading only by leave of court or by written consent of the adverse party; and leave shall be freely given when justice so requires.
>
> (c) Whenever the claim or defense asserted in the amended pleading arose out of the conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading, the amendment relates back to the original pleading.

10 C.F.R. § 212.168(a) (1980) provided:

> (a) *Exclusion of increased product costs attributable to ethane.* The total amount of increased product costs attributable each month to a given volume of natural gas shall be reduced each month by an amount equal to the product of the increased product costs multiplied by
>
> $$\left(\frac{Ve^n}{V^n}\right)$$
>
> where:

V^u=The total volume of all natural gas liquid products and ethane derived from that volume of natural gas and sold in the current month, and

Ve^u=The total volume of all ethane derived from that volume of natural gas and sold in the current month.

STATEMENT

1. *Regulatory setting.* The questions presented here concern the scope and proper application of the doctrine of laches. Because this suit was brought as a challenge to the validity of certain federal regulations, however, it is useful at the outset briefly to review the regulatory setting in which the case arose.

In December, 1974, DOE's predecessor, the Federal Energy Administration ("FEA"), promulgated extensive amendments to the federal petroleum allocation and price regulations. *See* 39 Fed. Reg. 44407 (Dec. 24, 1974). The principal purpose of the amendments, which became Subpart K of 10 C.F.R. Part 212, was to specify the method for calculating maximum lawful prices for natural gas liquids ("NGLs") processed from natural gas.

Prior to that time, NGLs had been subject to price controls under Subpart E of 10 C.F.R. Part 212, *see National Helium Corp. v. FEA*, 569 F.2d 1137 (TECA 1977), but there had been "no clearly applicable regulation or precise method by which a gas plant operator could have calculated his maximum allowable level of product prices." *Twin City Barge & Towing Corp. v. Schlesinger*, 603 F.2d 197, 200 (TECA 1979). As FEA itself had acknowledged, Subpart E was "not . . . well-suited for regulating prices of liquid products produced from natural gas by gas processors." 39 Fed. Reg. 32718, 32719 (Sept. 10, 1974).

The focus of Subpart E had been on products, such as gasoline and diesel fuel, produced from crude oil by refiners. Subpart E had provided that the maximum allow-

able prices for such products were to be computed by reference to the refiner's increased costs of crude oil. In making that computation, the refiner was required to disregard those portions of its increased costs that were allocated by a regulatory provision known as the "V-factor" to products that were exempt from price controls. *See* 10 C.F.R. § 212.83(c)(2)(ii) (1976). Those products—petroleum coke, petroleum wax, asphalt, and road oil—were substantially less valuable than gasoline or diesel fuel. Because the V-factor allocated costs on a purely volumetric basis, the effect was to assign a disproportionate amount of costs to lower-value products.

The notice of proposed rulemaking for Subpart K made no reference either to the V-factor or to the volumetric allocation of costs to exempt products. *See* 39 Fed. Reg. 32718 (Sept. 10, 1974). When Subpart K finally was adopted, however, it included a provision, known as the "ethane exclusion rule," which allocated the costs of natural gas shrinkage on a volumetric basis to ethane; the costs so allocated to ethane could not be recovered in the prices of other NGLs. *See* 10 C.F.R. § 212.168(a) (1980). Ethane, which was exempt from price controls by statute, is by far the least valuable of the NGLs. *See* 15 U.S.C. § 752(b) (1976); R. 5202 n.13, 4527 n.63.[2] As a consequence, the ethane exclusion rule, like the V-factor, allocated an amount of costs to a lower-value exempt product that was disproportionately large in relation to the proceeds that could be obtained from selling that product in the market-place.

2. *Background of this litigation.* Exxon brought this suit for declaratory judgment in the United States District Court for the Northern District of Texas in July, 1975, asking the district court to "[d]eclare that the method of valuation of natural gas liquids for pass-through purposes in 10 C.F.R. Part 212, Subpart K, is

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[2] "R." refers to the record in the court of appeals.

arbitrary and capricious, and is otherwise unlawful under the criteria set forth in 5 U.S.C. § 706(2)." R. 8. In February, 1978, the suit was consolidated with similar suits brought by other gas processors. R. 18.[3] The next four years were consumed with disputes over discovery and related pre-trial matters. *See* R. 194-2669.

In the meantime, the course of the litigation was affected by two parallel developments. *First*, the United States brought an enforcement action against Exxon in the United States District Court for the District of Columbia pursuant to section 209 of the ESA, alleging that Exxon had violated the very regulatory provisions whose validity Exxon was challenging in this case. *United States v. Exxon Corp.*, Civil Action No. 78-2078 (D.D.C., filed Nov. 1, 1978). That court, recognizing that the arguments advanced by Exxon in this case were in the nature of anticipatory defenses to the government's enforcement action and that considerations of judicial economy militated in favor of their being tried in this consolidated proceeding, stayed the government's action pending resolution of the underlying legal issues in this case. *Id.* (Order of Jan. 5, 1978).

Second, Mobil Oil Corporation ("Mobil") instituted a lawsuit challenging the validity of the V-factor in Subpart E. Relying upon *Bowman Transportation, Inc. v. Arkansas-Best Freight System, Inc.*, 419 U.S. 281 (1974), and *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402 (1971), TECA held that because "[i]t is clear from the record that at no time prior to promulgating the [V-factor] did the DOE even consider the relevant factors or objectives set out in [15 U.S.C.] § 753(b)(1), . . . the promulgation . . . [was] arbitrary and capricious and beyond the statutory authority of the agency . . . ." *Mobil*

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[3] All plaintiffs other than Exxon and Texaco Inc. ("Texaco") subsequently entered into settlements with DOE. *See* App. A, *infra*, at 3a, 5a n.4.

Oil Corp. v. DOE, 610 F.2d 796, 801-02 (TECA 1979), *cert. denied*, 446 U.S. 937 (1980).[4]

The decision in *Mobil* foreshadowed the invalidity of the ethane exclusion rule. It is clear, and indeed was undisputed in the district court, that the ethane exclusion rule was adopted without any consideration of the statutory objectives that Congress specifically had instructed the agency to achieve "to the maximum extent practicable." 15 U.S.C. § 753(b)(1) (1976). Three of DOE's employees who had participated in the Subpart K rulemaking testified that there had been no study or analysis of the relationship between the statutory objectives and either the ethane exclusion rule itself or the principle of volumetric cost allocation. R. 2115; 2161; 2166; 2360. Because the V-factor had been invalidly adopted in April, 1974, without consideration of the statutory objectives, and because there had been no consideration of those objectives between that time and the adoption of the ethane exclusion rule in December, 1974, the latter rule also was invalid.

3. *Proceedings in the district court.* After the decision in *Mobil*, and with the district court's permission, R. 1220, the plaintiffs filed a joint amended complaint that particularized their challenges to Subpart K. With respect to the ethane exclusion rule, the plaintiffs asked the district court to "[d]eclare that 10 C.F.R. § 212.167, to the extent that it requires the allocation of increased costs to ethane on a volumetric basis, is invalid and void." R. 1262. Thereafter, the parties filed cross-motions for summary judgment.

The case presented several distinct legal issues. The district court decided all of those issues, other than that

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[4] TECA further held that the V-factor rulemaking was deficient under 5 U.S.C. § 553 because the agency had failed to give prior notice and opportunity for comment. *Mobil Oil Corp. v. DOE*, 610 F.2d at 802-04.

relating to the ethane exclusion rule, in DOE's favor. *See generally* App. B, *infra*.[5] But DOE had conceded that the adoption of the ethane exclusion rule constituted "nothing more than the mechanical transfer of the existing 'V' factor allocation principle from Subpart E into Subpart K." R. 4385. In view of the fact that, when promulgating the ethane exclusion rule, the agency once again had failed to consider the statutory objectives and thus had done nothing to correct the legal infirmities imported from the V-factor, the district court held that the ethane exclusion rule was invalid under *Mobil*. App. B, *infra*, at 60a-63a. In so holding, the court rejected DOE's defense of laches, which had not been supported by any evidentiary showing of lack of diligence or prejudice. *Id.* at 63a.

4. *The opinion of the court of appeals.* TECA upheld all of the district court's rulings in favor of DOE. *See generally* App. A, *infra*. But without disposing of the plaintiffs' arguments relating to the invalidity of the ethane exclusion rule, TECA held that their suits were barred by laches.[6]

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[5] The district court reaffirmed those rulings on rehearing. *See* App. C, *infra*.

[6] The plaintiffs had challenged the ethane exclusion rule on five separate grounds—failure to consider the statutory objectives; economic irrationality; failure to publish the actual text of the rule in advance, as required by section 7(i) of the Federal Energy Administration Act, 15 U.S.C. § 766(i) (1976); failure to provide a statement of basis and purpose, as required by 5 U.S.C. § 553(c); and failure to give notice and opportunity for public comment, as required by 5 U.S.C. § 553(d). TECA addressed none of these arguments. TECA did mention the matter of notice, but only in the course of discussing whether the plaintiffs could have been expected to challenge the ethane exclusion rule earlier:

> [The] record indicates to us that [the plaintiffs] were reasonably on notice during the Subpart K rulemaking that a V-factor was being considered for ethane. But certainly they had full knowledge of the form as well as substance of the

TECA read the district court's opinion with respect to the ethane exclusion rule as turning not on the agency's failure to consider the statutory objectives but on "some *res judicata* or collateral estoppel effect of [TECA's decision in *Mobil*]." App. A, *infra*, at 30a. TECA held that in relying upon *res judicata* or collateral estoppel—doctrines that the district court in fact never had mentioned —"the trial court understandingly [*sic*] fell into error." *Id.* at 31a.

With that said, TECA refused any further consideration of the import of its decision in *Mobil*. The court acknowledged that "[t]here was a mechanical transfer of the [ethane exclusion] rule from its original location in Subpart E to [Subpart K]." *Id.* at 31a n.24. But the court did not comment on the implications of that fact or upon the agency's failure to consider the statutory objectives when promulgating the ethane exclusion rule. Instead, TECA "concluded that DOE's laches defense is dispositive." *Id.* at 32a.

Although Exxon's original complaint had been broadly worded, TECA brushed aside as "untenable" the plaintiffs' "assertion that [their] attacks against Subpart K prior to [the filing of the joint amended complaint in] 1981 were broad enough to challenge the ethane exclusion rule." App. A, *infra*, at 38a. The court completely ignored the plaintiffs' further contention that, under Fed. R. Civ. P. 15(c), the joint amended complaint related back to the dates of the original complaints. And the court was uninterested in the fact that the invalidity of the ethane exclusion rule was a defense to the government's pending enforcement action against Exxon. *Id.* at 37a, 37a-38a n.30. Even though DOE had presented no evidence on the factual elements of lack of diligence and

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ethane exclusion rule when Subpart K was published on December 24, 1974.

App. A, *infra*, at 35a (footnote omitted).

prejudice, and there thus was nothing whatsoever in the record on those points, TECA announced that "the record of controlling circumstances is clear and indisputable." *Id.* at 38a. On that basis, TECA held that the plaintiffs "by their laches are barred from questioning the substantive or procedural validity of the ethane exclusion rule during the period it was in effect as a part of Subpart K." *Id.* at 38a-39a.

REASONS FOR GRANTING THE PETITION

This Court has never reviewed a decision of TECA involving private rights or obligations under the petroleum allocation and price regulations, even though those regulations affected countless transactions involving in the aggregate hundreds of billions of dollars.[7] As a consequence, TECA has been free to proceed unconstrained by the settled doctrines that govern adjudication in other federal courts. This is an important case in point. TECA's decision on the issue of laches bears no relation to the usual doctrines of pleading, proof, and appellate review.

This case alone involves hundreds of millions of dollars.[8] The underlying problem it represents is one of grave and more general significance. As early as 1978,

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[7] The Court has reviewed only two of TECA's decisions: *Fry v. United States*, 421 U.S. 542 (1975) (application of federal wage controls to state employees), and *Tully v. Mobil Oil Corp.*, 455 U.S. 245 (1982) (validity of state tax on gasoline).

[8] At oral argument before TECA, counsel for DOE represented to the court that "the complaints in the enforcement actions do not charge [either Exxon or Texaco] with failure to apply the ethane exclusion rule." App. A, *infra*, at 37a n.30. When TECA's opinion was announced, however, that same lawyer advised the press that "Exxon and Texaco each are alleged to have improperly allocated more than $100 million in costs to price-controlled products that should have been allocated to ethane." Wall Street Journal, Dec. 20, 1984, at 2, col. 2.

one close observer of TECA reported that, in his view, the court consistently had defaulted in its obligation to provide fair and impartial judicial review:

> A review of the decisions of the TECA supports the conclusion that the court has shown little concern for "principled fairness." The TECA has abdicated its judicial responsibility by its deference to administrative agencies, its failure to secure agency compliance with procedural safeguards and its unwillingness to closely scrutinize the series of emergency economic regulatory programs which were spawned during the 1970's.
>
> . . . [T]he TECA has developed an "institutional bias" in favor of agency policy and has become "caught up in the agency's mission as its reason for being and basis for succeeding."

Elkins, *The Temporary Emergency Court of Appeals: A Study in the Abdication of Judicial Responsibility*, 1978 Duke L.J. 113, 151 (footnote omitted).[9] The situation has not improved. Over the past several years, TECA has done little more than ratify and endorse DOE's enforcement positions.[10] As a consequence, lawyers who rep-

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[9] The author of that study was a law professor who previously had been "a trial attorney in the Economic Stabilization Section, Department of Justice, assigned to litigation of rent and price control cases." 1978 Duke L.J., *supra*, at 113 n.*.

[10] In connection with the preparation of this petition, we have reviewed each case decided on the merits by TECA during the past five years, 1980 through 1984, in which DOE was a party. Out of a total of 74 cases, 50 were appeals taken by the private party. In every one of those 50 cases, TECA affirmed the trial court's judgment in favor of DOE (100.0 percent). Indeed, although TECA once reversed a criminal conviction, *United States v. Heller*, 635 F.2d 848 (TECA 1980), it appears that, since TECA's inception in 1971, TECA has never reversed a civil judgment in DOE's favor on the merits of a regulatory issue.

The remaining 24 cases were appeals taken by DOE. TECA reversed in 18 of these cases (75.0 percent), even though DOE, unlike

resent producers, refiners, gas processors, and other members of the American petroleum industry have become concerned that their clients may not receive fair hearings before TECA. *See* American Bar Association, Administrative Law Section, *Recommendations and Report to the House of Delegates, American Bar Association: Report on Appellate Review for Emergency Programs* 11 (1984).[11]

Only this Court can supply the necessary corrective. Occasional review of TECA's decisions by this Court would provide the institutional discipline necessary to ensure fair and responsible decision-making. This case offers an appropriate occasion for the exercise of this Court's discretionary power of review. TECA's ruling on laches is seriously out of harmony with established legal principles in several major respects. It disregards and is contrary to decisions of this Court and is in conflict with decisions of other courts of appeals as well.

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other federal agencies, regularly follows the practice of taking an appeal whenever it loses. Thus, in TECA's view, there has been a curious asymmetry in the decisions of the district courts: the district courts have been right every time they ruled for DOE but wrong three times out of four when they ruled against DOE.

In summary, TECA decided 68 of the 74 cases in DOE's favor (91.9 percent). This represents the acceleration of a trend established earlier. A published study of the period from June 14, 1972, to June 8, 1976, concluded that TECA had decided 53 out of 63 cases in DOE's favor (84.1 percent). *See* Burke, *Report to ABA Economic and Resources Controls Committee on Economic Stabilization Program Litigation*, 32 Bus. Law. 1259, 1286 (1977).

[11] This unfortunate state of affairs is by no means merely a matter of historical interest. Despite the "Temporary" in its name, TECA is expected to be with us for many years to come.

> Billions of dollars are still at issue in this legal pipeline, with 710 cases now before [DOE's] Office of Hearings and Appeals alone . . . . Many of these are likely to wind up at TECA in coming years.

New York Times, Nov. 5, 1984, at B10, col. 4.

1. *The decision below conflicts with this Court's holdings that a defendant must offer evidentiary proof of laches, that a plaintiff must be given an opportunity to present counter-evidence, and that a court of appeals may not merely substitute its judgment for that of the district court.* "Laches requires proof of (1) lack of diligence by the party against whom the defense is asserted, and (2) prejudice to the party asserting the defense." *Costello v. United States*, 365 U.S. 265, 282 (1961). The burden is on the defendant to establish those two factual elements. *Matter of Bohart*, 743 F.2d 313, 326-27 (5th Cir. 1984); *Kobell v. Suburban Lines, Inc.*, 731 F.2d 1076, 1091-92 n.27 (3d Cir. 1984). "[T]he existence of laches is a question primarily addressed to the discretion of the trial court." *Gardner v. Panama Railroad Co.*, 342 U.S. 29, 30 (1951). When a district court rejects the defense of laches, a court of appeals "ha[s] no warrant to reverse this finding [unless it is] plainly erroneous." *Gutierrez v. Waterman Steamship Corp.*, 373 U.S. 206, 215 (1962).

TECA disregarded all of these precepts. Far from furnishing proof of lack of diligence and prejudice, DOE had made no evidentiary showing whatsoever on those points. The case was presented to the district court on cross-motions for summary judgment; on the question of laches, therefore, the court was required to draw all inferences favorable to the plaintiffs. *See, e.g., Harlow v. Fitzgerald*, 457 U.S. 800, 816 n.26 (1982); *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 157 (1970). In these circumstances, the district court had no choice but to reject the defense of laches, and it did so. Yet TECA, without any relevant evidence before it, reversed on the basis of its own unsupported belief that DOE had been prejudiced. This result is squarely inconsistent with this Court's decision in *Gutierrez*. There, as here, a court of appeals improperly substituted its judgment for that of the district court on the issue of laches. Here, as there, this Court should reverse.

TECA widely departed from established doctrine, moreover, in holding that the defense of laches may be sustained in the absence of any proof or evidence at all. In analogous circumstances, other courts of appeals uniformly have refused to sustain an asserted defense of laches. *See, e.g., Leinoff v. Louis Milona & Sons, Inc.*, 726 F.2d 734, 742 (Fed. Cir. 1984); *University of Pittsburgh v. Champion Products Inc.*, 686 F.2d 1040, 1046-47 n.19 (3d Cir.), *cert. denied*, 459 U.S. 1087 (1982); *Bratton v. Bethlehem Steel Corp.*, 649 F.2d 658, 667 (9th Cir. 1980); *Pegues v. Morehouse Parish School Board*, 632 F.2d 1279, 1283 (5th Cir. 1980), *cert. denied*, 451 U.S. 987 (1981); *EEOC v. Massey-Ferguson, Inc.*, 622 F.2d 271, 276 (7th Cir. 1980); *EEOC v. South Carolina National Bank*, 562 F.2d 329, 332 (4th Cir. 1977); *National Association of Broadcasters v. FCC*, 554 F.2d 1118, 1128 n.25 (D.C. Cir. 1976); *Larios v. Victory Carriers, Inc.*, 316 F.2d 63, 66-67 (2d Cir. 1963).

Furthermore, because DOE had made no evidentiary showing in the district court, there had been no occasion for the presentation of counter-evidence by the plaintiffs. By reversing the district court's decision on laches upon the basis of a purely imaginary "record," App. A, *infra*, at 38a, TECA deprived the plaintiffs of any opportunity for rebuttal. This case thus is like *Czaplicki v. The Hoegh Silvercloud*, 351 U.S. 525 (1956). There, as here, the district court had not accepted the proffered defense of laches, yet the court of appeals had upheld that defense in circumstances where the plaintiff had not been given an adequate opportunity to offer counter-evidence. This Court reversed, holding that the defense of laches raised "questions on which the parties should have been allowed to present evidence." *Id.* at 534. Here, as in *Czaplicki*, the state of the record precluded the appellate imposition of a time bar.[12]

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[12] TECA's error was not merely harmless. If DOE had attempted to make the necessary showing in the district court, the plaintiffs

2. *TECA disregarded this Court's directive that pleadings are to be liberally construed and failed to give effect to this Court's decisions under Rule 15(c).* The very pleadings in this case precluded recognition of the defense of laches. Exxon's original complaint was filed in July, 1975, shortly after the ethane exclusion rule was adopted in December, 1974. The complaint broadly challenged "the method of valuation of natural gas liquids for passthrough purposes in 10 C.F.R. Part 212, Subpart K." R. 8. The ethane exclusion rule constituted an integral part of the method of valuing NGLs for passthrough purposes. The ethane exclusion rule was set forth in Subpart K; it allocated certain costs to ethane; by doing so, it prevented those costs from being included in the computation of the maximum lawful prices that a processor could charge for other NGLs. The ethane exclusion rule thus was included among those regulatory provisions that were subject to challenge.

In short, a fair and reasonable reading of Exxon's original complaint leaves no room for the defense of laches. Fed. R. Civ. P. 8(f), moreover, directs that "[a]ll pleadings shall be so construed as to do substan-

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would have been able to refute that showing. (1) There was no lack of diligence. The original complaints adequately put DOE on notice that the entirety of Subpart K was at issue, and the plaintiffs reasonably awaited the conclusion of the parallel litigation over the V-factor before particularizing the grounds for their challenge to the ethane exclusion rule. (2) Nor was there any prejudice to DOE. TECA apparently perceived prejudice in the fact that, because of the decontrol of crude oil prices, "it was too late for the agency to attempt to adjust the regulatory system should the challenge have been successful." App. A, *infra*, at 38a. But DOE made no attempt to adjust the V-factor when it was being challenged; accordingly, there is no reason to believe it would have attempted to adjust the ethane exclusion rule either. And TECA itself held, in connection with the V-factor, that retroactive adjustment is not permissible. *Mobil Oil Corp. v. DOE*, 678 F.2d 1083 (TECA 1982). Since DOE would not have cured the deficiencies of the ethane exclusion rule during litigation and could not have done so afterwards, it was not prejudiced by any alleged delay in challenging that rule.

tial justice." Yet TECA ignored Rule 8(f), pronounced Exxon's reading of its complaint to be "untenable," App. A, *infra*, at 38a, and asserted that Exxon had "fail[ed] to take any action to question [the ethane exclusion rule] until July, 1981." *Id.* at 35a.

TECA's action is inconsistent with this Court's decision in *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500 (1959). In that case, the prayer for relief by its terms had asked only for an injunction against lawsuits. Observing that "liberal construction of a pleading is in line with Rule 8," *id.* at 506, this Court construed the prayer as reasonably encompassing a request for an injunction against the threat of suit as well.

TECA erred in not following *Beacon Theatres* as a guide to the proper construction of Exxon's complaint. *See also Conley v. Gibson*, 355 U.S. 41, 48 (1957) ("[t]he Federal Rules reject the approach that pleading is a game of skill in which one misstep by counsel may be decisive . . ."). Other courts of appeals have followed this Court's example in liberally construing the theory of relief set forth in a complaint. *See, e.g., Certified Corp. v. Hawaii Teamsters and Allied Workers*, 597 F.2d 1269, 1272 (9th Cir. 1979); *Hazen v. Western Union Telegraph Co.*, 518 F.2d 766, 770 (6th Cir. 1975); *Bramlet v. Wilson*, 495 F.2d 714, 716 (8th Cir. 1974); *Maynard v. General Electric Co.*, 486 F.2d 538, 539 (4th Cir. 1973); *Patch v. Stanley Works*, 448 F.2d 483, 487-88 (2d Cir. 1971). TECA alone has refused to be faithful to the spirit of Rule 8(f).

But even if Exxon's original complaint had not embodied a challenge to the validity of the ethane exclusion rule, the plaintiffs' joint amended complaint, which was filed by leave of court pursuant to Fed. R. Civ. P. 15(a), R. 1220, explicitly set forth that challenge. R. 1262. DOE did not oppose the plaintiffs' motion for leave to file the amended complaint, nor did it request reconsideration of the order granting leave. DOE made no show-

ing in the district court that it would or could be prejudiced by the filing. In those circumstances, the district court's decision to permit amendment under Rule 15(a) was correct, and DOE rightly chose not to challenge that ruling on appeal. "It is settled that the grant of leave to amend the pleadings pursuant to Rule 15(a) is within the discretion of the trial court." *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 401 U.S. 321, 330 (1971). Moreover, "Rule 15(a) declares that leave to amend 'shall be freely given when justice so requires'; this mandate is to be heeded." *Foman v. Davis*, 371 U.S. 178, 182 (1962).

These considerations should have been fatal to DOE's defense of laches. Fed. R. Civ. P. 15(c) provides that "[w]henever the claim or defense asserted in the amended pleading arose out of the conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading, the amendment relates back to the date of the original pleading." Under Rule 15(c), therefore, the claims asserted in the plaintiffs' joint amended complaint, even if otherwise tardy, were timely because they related back to the date of Exxon's original complaint.

The very purpose of Rule 15(c) is to preclude the assertion of a time bar. *See Rural Fire Protection Co. v. Hepp*, 366 F.2d 355, 362 (9th Cir. 1966). In recognition of that purpose, this Court has held that Rule 15(c)'s doctrine of relation-back nullifies the effect of a statute of limitation where, as here, the original pleading was prompt and timely. *Tiller v. Atlantic Coast Line Railroad*, 323 U.S. 574, 580-81 (1945). *See also Maty v. Grasselli Chemical Co.*, 303 U.S. 197, 201 (1938); *New York Central & Hudson River Railroad v. Kinney*, 260 U.S. 340, 346 (1922). Because Rule 15(c) overrides the legislative prescription of a rigid statutory period of limitation, *a fortiori* it overrides the flexible, judge-made doctrine of laches. *See Bush v. Sumitomo Bank and Trust*

Co., Ltd., 513 F. Supp. 1051, 1053 (E.D. Tex. 1981); *Hirshhorn v. Mine Safety Applicances Co.*, 101 F. Supp. 549, 553-54 (W.D. Pa. 1951), *aff'd*, 193 F.2d 489 (3d Cir. 1952). TECA's decision to the contrary should be reversed.

3. *The decision below needlessly multiplies litigation.* TECA's decision postpones but does not obviate the need for judicial consideration of the validity of the ethane exclusion rule. In discussing the issue of laches, the court explicitly adopted its prior reasoning in *Mobil Oil Corp. v. DOE*, 728 F.2d 1477 (TECA 1983), *cert. denied*, 104 S.Ct. 3545 (1984). App. A, *infra*, at 38a.[13] In that case, TECA held that "laches does not run against a defense" and proceeded to decide the merits of an issue because it had been raised as a defense. 728 F.2d at 1489. *See also Northern Pacific Railway Co. v. United States*, 277 F.2d 615, 624 (10th Cir. 1960) ("laches . . . cannot be invoked by [a] plaintiff to bar rights asserted by [a] defendant merely by way of defense").

Exxon, therefore, will be able to assert the invalidity of the ethane exclusion rule as a defense to the government's pending enforcement action. This result, of course, in itself is sound. *See Charles R. Krimm Lumber Co. v. Turney*, 168 F.2d 72, 76 (Em. App. 1948) ("[i]f the government insists upon pressing that enforcement action, we see nothing 'inequitable' in permitting complainants, even at this late day, to press their defense of invalidity, pursuant to the only procedure open to them. . ."). But the net effect of TECA's decision is a pointless multiplication of litigation. Having litigated the validity of the ethane exclusion rule once, in this case, the parties now

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[13] TECA departed from its earlier ruling in one major respect. In *Mobil*, the court had recognized that the trial court must make "factual findings on the question [*sic*] of delay and prejudice." 728 F.2d at 1489. Here, TECA asserted the existence of inexcusable delay and prejudice even though the trial court had made no findings and there was no evidence in the record to support any findings.

must do so again in the pending enforcement action. This runs counter to the important goal of judicial economy. *Cf. Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 326 (1979); *F.D. Rich Co. v. United States ex rel. Industrial Lumber Co.*, 417 U.S. 116, 125-26 (1974).

TECA's error was in not deciding the issues properly before it. Courts should not permit the defense of laches to be invoked, as DOE has done here, merely as a device to postpone adjudication and multiply litigation.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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JANUARY 1985

APPENDICES

APPENDIX A

TEMPORARY EMERGENCY COURT OF APPEALS OF THE UNITED STATES

Nos. 5-104, 5-105 and 5-107 (Consolidated)

EXXON CORPORATION, and TEXACO, INC.,
Plaintiffs-Appellants and Cross-Appellees,

v.

UNITED STATES DEPARTMENT OF ENERGY, and DONALD P. HODEL, Secretary of Energy,
Defendants-Appellees and Cross-Appellants.

On Appeal from the United States District Court for the Northern District of Texas

No. CA-3-75-0836-W (Consolidated)

MEMORANDUM DECISION

(Argued: September 27, 1984
Decided: December 17, 1984)

Before CHRISTENSEN, WILLIAM H. BECKER and BROWN, Judges.

CHRISTENSEN, Judge.

THE PROBLEM

A natural gas stream as it is produced from a gas reservoir is a mixture of natural gas liquids (NGLs)[1]

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[1] Natural gas liquids (NGLs) and their products (NGLPs) include propane, butane, natural gasoline and ethane. In Mobil Oil

and methane. When a producer extracts NGLs from this "wet" gas stream instead of marketing it as such, volumetric (Mcf), and thermal (Btu) values of the stream are reduced. "Subpart K" and "Subpart E" (as later harmonized with Subpart K retroactively) of the regulations under the Emergency Petroleum Allocation Act (EPAA) first recognized this "shrinkage" as a product cost for authorized recovery through increases in maximum allowable prices of NGLs and NGLPs above base levels.

How the cost of shrinkage was to be measured for this purpose is what the appeal of Exxon Corporation and Texaco, Inc., largely is about, with a related problem presented on the cross-appeal of the Department of Energy (DOE) concerning the "ethane exclusion rule" allocating a part of such shrinkage costs to exempt ethane for the purpose of constricting their pass-through to costs of covered products.

THE CASE

These consolidated actions were initiated in the Northern District of Texas when, in June 1975, Dorchester Gas Producing Company and an affiliated firm filed a pre-enforcement declaratory judgment suit against the Department of Energy (DOE) and Exxon filed a similar action in July 1975. Later the cases were consolidated. Texaco, Inc., Mobil Oil Corporation, Phillips Petroleum Company and Pennzoil Company intervened as additional

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Corp. v. Federal Energy Administration, 566 F.2d 87, 88 (Em. App. 1977), we held that the agency had authority "to regulate the allocation and pricing of all liquid petroleum products recovered from the 'wet' natural gas streams, including condensation, natural gas liquids and natural gas liquid products recovered at gas processing plants . . . except ethane, which is expressly exempted from regulation by Section 3(6) of the Act." *See also* Nat. Helium Corp. v. Federal Energy Administration, 569 F.2d 1137 (Em. App. 1977).

plaintiffs. All plaintiffs in these proceedings other than Exxon, Texaco and Mobil were dismissed in the district court by reason of stipulated settlements. Similar suits were filed in the same district by Cities Service Company and Amoco Production Company which also were dismissed following settlements.[2]

After extensive discovery, the parties filed cross-motions for summary judgment. In a comprehensive memorandum opinion, Chief Judge Halbert O. Woodward "granted summary judgment" in favor of the Department of Energy on all issues except that of the validity of the ethane exclusion rule, as to which summary judgment "was granted" in favor of plaintiffs. Dorchester Gas Prod. Co. v. U.S. Department of Energy, 582 F. Supp. 911 (N.D. Tex. 1983).

Plaintiffs filed various motions for new trial or reconsideration. Exxon moved to have certified to this court the question whether the EPAA and the Energy Policy and Conservation Act were unconstitutional by reason of their legislative veto provisions. The district court following further briefing and argument filed on November 23, 1983, a "Memorandum Order" reexamining and reaffirming its rulings on the issues now before us and certifying the constitutional question to this court pursuant to section 212 of the Economic Stabilization Act of 1970, 12 U.S.C. § 1904 note. Dorchester Gas Prod. Co. v. U.S. Dept. of Energy, 582 F. Supp. 927 (N.D. Tex. 1983).

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[2] The agency filed enforcement actions in the United States District Court for the District of Columbia against nine refiners, including the appellants before us, alleging that they had improperly computed increased costs for NGLs. These cases were stayed pending the resolution of the Texas actions and another case then pending in the District of Delaware involving different issues, later decided against the Department of Energy and affirmed by this court in Gulf Oil Corp. v. Department of Energy, 671 F.2d 485 (Em. App. 1982).

The District Judge enumerated the following conclusions in his Memorandum Order, 582 F. Supp. 927 at 937:

> 1. Both the plaintiffs' intra-firm transfer price method and alternative incremental method are unreasonable under Subpart E.
>
> 2. DOE's interpretation of Subpart K is reasonable in light of the purpose of Subpart K.
>
> 3. The plaintiffs' exclusion of fixed-quantity contracts from the calculation of the weighted-average cost of shrinkage is unreasonable under Subparts E and K. In short, the weighted average cost of shrinkage reflects what processors were receiving under contracts in effect for their processed gas; and under either Subpart E or Subpart K, the exclusion of fixed-quantity contracts overstates what was actually received and is thus contrary to the purposes of the regulations.
>
> 4. DOE's promulgation of Subpart K was not arbitrary and capricious.
>
> 5. The one-house veto provisions in the EPAA and EPCA present substantial constitutional questions.
>
> 6. The court has considered the relevant agency rulings and interpretations and, as discussed in the original Memorandum Opinion, finds that they support rather than refute DOE's position in this case.

After denying the various motions for new trial and reconsideration he added: "In accordance with the Memorandum Opinion issued June 24, 1983, the plaintiff's Motion for Summary Judgment with regard to the ethane exclusion is granted, and the defendants' corresponding motion is denied. The defendant's Motion for Summary Judgment on all other issues is granted, and the plaintiff's motion denied." [3]

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[3] Counsel were directed to confer and submit a judgment in accordance with the Memorandum Order. The same day a "Judgment" (the record does not indicate whether this was the form

Finally, the district court filed a supplemental memorandum rejecting Texaco's estoppel contention as barring summary judgment disposition. Dorchester Gas Prod. Co. v. U.S. Dept. of Energy, 582 F. Supp. 927 at 937 (N.D. Tex. 1983).

Separate appeals were taken by the remaining plaintiffs [4] concerning the issues now before us and DOE filed

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submitted by counsel) was signed, simply reiterating the "granting" or "denial" of the respective motions and ordering that the "joint amended . . . complaint is dismissed with prejudice." The parties respectively appealed therefrom. The case was briefed, argued and submitted in this court without any question arising concerning the form of judgment.

In preparing this opinion we have found a troublesome interplay among the "final decision" requirement of 28 U.S.C. § 1291, the reference to "judgment" in rule 15 of our own rules, the separate-document requirement of Rule 58, Fed. R. Civ. P., the "declaratory" element inhering in the concept of a declaratory judgment, and some suggestion among the authorities that the granting or denial of a motion is not necessarily equivalent to a final decision for the purposes of appeal. *See, e.g.*, Yeager v. Drug Enforcement Administration, 678 F.2d 315, 319, n.10 (D.C. Cir. 1982).

After examining our appellate jurisdiction in compliance with our continuing duty to do so, Exxon Corp. v. Federal Energy Admin., 516 F.2d 1397 (Em. App. 1975), we have concluded that we properly can and should treat the judgment of December 21, 1983, as incorporating the declarations of fact and law in the court's memorandums as the trial court and the parties have, and that, as such, it constitutes an appealable decision over which this court has jurisdiction. Athenian Realty Corp. v. Southwestern Bell Tel. Co., 338 F.2d 1001 (5th Cir.), *cert. denied*, 380 U.S. 953 (1964). *See also* Bankers Trust Co. v. Mallis, 435 U.S. 381 (1978); U.S. v. Schaefer Brewing Co., 356 U.S. 227 (1958); United States v. Hark, 320 U.S. 531 (1944). *Cf.* Bragg v. Reed, 592 F.2d 1136, 1138 (10th Cir. 1979).

[4] Upon stipulation filed August 13, 1984, Mobil Oil Corporation's appeal was dismissed and Mobil was dismissed as a party to the Department of Energy's cross-appeal, leaving Exxon and Texaco as the appellants now before us. They will be referred to generally hereafter as "the appellants," and the appellees/cross-appellants will be referred to as "DOE."

a cross-appeal as before indicated. The appeals were consolidated here but briefing on the merits was delayed pending determination of the constitutional question. On July 6, 1984, we held with respect to the certified issue that the inclusion of the legislative veto provisions did not render the remainder of the Acts unconstitutional. Exxon Corp. v. Dept. of Energy, and In Re: The Department of Energy Stripper Well Exemption Litigation, 744 F.2d 98 (Em. App.), *cert. denied*, —— U.S. —— (S.Ct. No. 84-188, Dec. 3, 1984). *See also* Gulf Oil Corp. v. Dyke, 734 F.2d 797 (Em. App.), *cert. denied*, —— U.S. —— (S.Ct. No. 84-20, Oct. 1, 1984).

FACTUAL AND REGULATORY BACKGROUND [5]

Approximately 800 gas plants were operating in the United States during the relevant period. When natural gas from a particular lease was dedicated exclusively to one customer under a reserve commitment contract, as ordinarily was the case,[6] that customer had the right to take the additional gas that would have been available in the absence of proceeding. But residue gas was sometimes sold under fixed-quantity contracts, leaving processors in varying circumstances free to market incremental quantities to the same or other customers under surplus contracts or on the open market. The present litigation has arisen because of the latter circumstances.

Natural gas from which NGLs and NGLPs are produced, as distinguished from the products themselves, was never subject to price controls, being expressly exempted from regulation by the original Phase IV rules.

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[5] Regulatory references unless otherwise indicated are to the designations current during the relevant times, because price controls now have expired.

[6] DOE audits revealed that Exxon had approximately 88 gas plants, Texaco 108. Appellants do not claim any problem in computing the cost of natural gas shrinkage pursuant to Subpart K where this normal situation existed.

38 Fed. Reg. 22536, 22538 (Aug. 22, 1973). Ethane was statutorily exempt under the EPAA (§ 3(1)(A)(6), 15 U.S.C. § 752(1)(A)(6)). Other NGLs and NGLPs were covered by the controls of Subpart E,[7] but no method had been adopted expressly for calculating their increased product costs, and the shrinkage disincentive for their production had not been dealt with by the agency.

Subpart E was oriented mainly toward crude oil refiners. Adjustment of the maximum lawful selling prices for refined products from the price levels of May 15, 1973, could be made on the basis of increased costs of raw materials used to produce them after that date. Increased costs then could be allocated among the refined products sold. Only a *pro rata* share could be allocated to certain special products, but there was no limit for allocations to other products, including NGLs and NGLPs. Because of such unlimited allocation to propane. resultant price increases imposed excessive hardship on consumers.

The Federal Energy Administration accordingly adopted a "Special Propane Rule" prohibiting refiners from allocating more than a *pro rata* share of increased crude oil costs to propane based upon the ratio of its total sales volume to the total sales volume of all covered products. 39 Fed. Reg. 4450 (Feb. 1974).

In the preamble to the amendment the FEA stated:

> The emergency special propane rule further provides that no increased costs may be calculated by refiners for domestic natural gas liquids and propane which are acquired from an affiliated entity . . . [I]ncreased costs of natural gas liquids have generally been minimal and there has been no precise

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[7] "Subpart E" refers to Subpart E of Part 212 of Title 10, C.F.R. ("Refiners"). "Subpart K," hereinafter discussed, refers to Subpart K of Part 212 of Title 10, C.F.R. ("Natural Gas Liquids").

> method for passing any increased costs through in the present regulations. The FEA is aware of the need for improving its regulations in this area and will be proposing amendments for this purpose in the immediate future. In the meantime, the amount of increased product costs which may be passed through by refiners is subject to the general principle that such increased costs are limited to those cost increases which reflect payment of lawful prices.

Addressing the need thus perceived, the FEA on September 10, 1974, proposed the addition of a new Subpart K to regulate the costing and pricing of NGLs and NGLPs with the objective of maintaining prices "as low as is reasonably possible without adversely affecting the availability of the product." 39 Fed. Reg. 32719 (1974). After receiving comments from the industry and conducting public hearings, the agency on December 24, 1974, published the new Subpart K, effective January 1, 1975. 39 Fed. Reg. 44407 (1974).

The preamble to Subpart K, after reviewing problems concerning a cost-based system and other alternatives, stated:

> As the foregoing summary indicates there is no single ideal solution to the regulation of natural gas liquid prices, and the regulations adopted by the FEA today are a necessary compromise among the conflicting considerations which must be taken into account. As stated in the September 10 Notice, the fundamental objective is to permit prices that will be as low as reasonably possible without adversely affecting the availability of the product. The adverse effects of price disparities stemming from the differing costs of crude oil and natural gas on the distribution sector of the industry, and the added demand for natural gas liquid products priced at less than the price for BTU equivalent crude petroleum derived products, were also among the problems adverted to by the FEA in its September 10 Notice. A further

important consideration in this proceeding is that the FEA must ensure, to the maximum extent practicable, that its regulations do not have an undue adverse impact on any particular segment of the industry, and that established relationships and operations in the industry are not unnecessarily disrupted.

* * * *

V Increased cost of natural gas shrinkage—For natural gas processing, the equivalent of increased product cost is the increase in the cost of the "shrinkage" which occurs in the natural gas stream from which the liquids are extracted, as a result of the extraction of the liquids. The "cost" of such shrinkage is the reduction in sales revenues received from the natural gas because of the reduced gas volume or BTU content of the gas after processing. Where the price permitted to be charged for natural gas has increased since May 15, 1973, an increased cost of "shrinkage" resulting from extraction of the liquids has been the result. The FEA has determined that this cost increase is the equivalent of increased product cost, and shall therefore be permitted to be passed through in the prices charged for natural gas liquid products so that the economic incentive to remove the liquids from the natural gas stream will not be lost.

39 Fed. Reg. 44408, 44409 (Dec. 24, 1974).

Subpart K itself allowed processors to pass through natural gas shrinkage as an "increased product cost" by these provisions:

(a) The first sale price of natural gas in liquids or natural gas liquid products may be increased in each month as provided in § 212.167, to reflect on a dollar for dollar basis, increased product costs since May 1973 attributable to the production of such natural gas liquids or natural gas liquid products.

(b) Increased product costs are . . . (3) the difference between the weighted average cost of natural gas shrinkage per thousand cubic feet (MCF) of natural gas processed in the month of May 1973, and

> the weighted average cost of natural gas shrinkage per thousand cubic feet (MCF) of natural gas processed in the current month, multiplied by the number of thousand cubic feet (MCF's) of natural gas processed in the current month.

10 C.F.R. § 212.167(a), (b) (1979), previously numbered § 212.166(a), (b).

"Cost of shrinkage" was defined in the definitional subsection of Subpart K as

> [t]he eduction in selling price per thousand cubic feet (MCF) of natural gas processed, which is attributable to the reduction in volume or BTU value of the natural gas resulting from the extraction of natural gas liquids, as determined pursuant to the contract in effect at the time for which cost of natural gas shrinkage is being measured, and under which the processed natural gas is sold.

10 C.F.R. § 212.162.

Included in Subpart K was the so-called ethane exclusion rule requiring a volumetrically proportionate allocation of the cost of natural gas shrinkage to ethane. The principle of volumetric cost allocation had been utilized earlier in 10 C.F.R. § 212.83(c)(2) which required volumetrically proportionate allocation of crude oil costs to exempt products derived from crude oil. We held the incorporation of the "V-factor" in this earlier regulation substantively and procedurally invalid in Mobil Oil Corp. v. Department of Energy, 610 F.2d 796 (Em. App. 1979), *cert. denied*, 446 U.S. 937 (1980). When cross-appeal issues involving the ethane exclusion rule of Subpart K are later discussed, we shall review its antecedents more particularly.

Subpart K coped with the problem of gas producers only prospectively. To rectify the earlier harsh effects of Subpart E on most gas processors, particularly small independents, the agency later adopted a Class Exception,

40 Fed. Reg. 23320 (May 29, 1975), which among other things allowed processors to adjust retroactively their banks of unrecovered cost increases to reflect the adjusted base period pricing first permitted by Subpart K. At the same time, it issued Ruling 1975-6, 40 Fed. Reg. 23272 (May 29, 1975), indicating that it would not enforce the restrictive provisions of Subpart E which had prevented most gas processors from legally charging more than their May 15, 1973, prices. In doing so it stated that "where the natural gas sales revenues are reduced by processing and where the selling price of the natural gas that has been processed has increased since May 15, 1973, the cost of shrinkage resulting from extraction of the liquids will also have increased [and will be considered] 'an increased product cost' under § 212.83 [of Subpart E]." *Id.* 23273.

During the Subpart E period, and until 1976, Texaco used an interaffiliate transfer pricing method of calculating increased costs to be discussed hereafter. During 1976 and early 1977, it used the weighted-average method of calculating cost of shrinkage as advocated by DOE, considering the sales price for all of its gas contracts, including fixed-quantity contracts and contracts for the sale of surplus gas. In May 1977, Texaco began using an "incremental method"; that is, it calculated shrinkage costs based on higher priced surplus contracts for the relevant month, excluding from the calculation the price received during the month under satisfied fixed-quantity contracts. In December 1978, it refiled to claim increased costs for the period prior to May 1977 entirely on the basis of its incremental method.

Exxon passed through no increased costs for NGLs during August, September and October 1973. During November 1973 through March 1974, it computed increased costs under a formula permitted for old crude oil. In April 1974, it again changed methods and until December 1974 utilized a transfer pricing method based

on its historical system of accounting. This formula utilized Exxon posted prices for propane and motor gasoline. Exxon refiled, seeking to make this transfer pricing method effective from November 1973. During the Subpart K period, Exxon employed the incremental method of calculating shrinkage which appellants espouse on this appeal.

THE ISSUES ON APPEAL

The parties do not question that the case was ripe for dispositive summary judgment, except for Texaco's contention that its estoppel claim was not subject to resolution against it in the absence of trial. Other issues were argued in the district court by the present appellants or other parties no longer involved which were not preserved for review.[8] Thus the issues presented on this appeal are these:

> I. Did the district court err in construing Subpart K as requiring the cost of natural gas shrinkage to be calculated by using the weighted-average price of all residue gas sales contracts (including "satisfied fixed-quantity contracts"), rather than disregarding the latter and looking solely to other contract prices appellants could have received if the gas had been sold without processing?

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[8] Appellants have abandoned among other contentions advanced in the district court their attack upon the procedural validity of "Subpart K," aside from the Ethane Exclusion Rule the validity and interpretation of which is sharply at issue on this appeal along with the interpretation of other provisions of Subpart K.

No issue was raised either in the district court or on appeal concerning the propriety of the declaratory judgment remedy in the context of this preenforcement action and we, therefore, express no opinion on the point. *See* Texas Energy Reserve Corp. v. Dept. of Energy, 710 F.2d 814 (Em. App. 1983); Hawthorne Oil & Gas Corp. v. Department of Energy, 647 F.2d 1107 (Em. App. 1981). *Cf.* Department of Energy v. State of Louisiana, 690 F.2d 180 (Em. App. 1982), *cert. denied*, 103 S.Ct. 1522 (1983).

II. Did the district court err in granting summary judgment for DOE in the face of Texaco's claim that the agency was estopped from denying the propriety of Texaco's costing method in view of advice from DOE personnel?

III. Did the trial court err in construing Subpart E as precluding calculation of NGL increased product costs either by appellants' "incremental costing" theory (ignoring the satisfied fixed-quantity contracts) or by reference to transfer prices for NGLs determined in accordance with generally accepted accounting practices?

IV. Did the district court err in determining that appellants were not guilty of laches and thus barred from questioning the ethane exclusion rule?

V. Did the district court err in finding the latter rule to be invalid by reason of a prior decision of this court and, if so, should the issue of the rule's validity be resolved here, or by the district court in the first instance upon remand?

DISCUSSION

Appellants maintain that fixed-quantity contracts existing during the period of measurement were irrelevant for the purposes of the shrinkage formula; that DOE's position is contrary to the congressional mandate that price regulations allow a dollar-for-dollar passthrough in net cost increases to covered products under 15 U.S.C. § 753(b)(2)(A), and that it would have extinguished economic incentive for NGL extraction, thus violating the purposes of the EPAA and regulations promulgated thereunder. Their present position is that the "relevant" prices on the basis of which shrinkage could be calculated were those contained in surplus contracts under which sales would have been made had there been no shrinkage or upon the extension of prices actually collected for a limited quantity of residual gas sold under surplus con-

tracts to the larger quantities that might have been sold had there been no shrinkage.

DOE suggests that appellants did not present their present theory in the court below; that there they argued that shrinkage costs should be based upon the market or upon unregulated prices for which the remaining gas could have been sold without the constraints of even surplus contract prices. It does seem that on this appeal appellants have moved more particularly toward the language of Subpart K by emphasizing that their incremental costing or "opportunity" method is based on sales that could have been made under higher-priced surplus contracts in existence during the month of measurement. But we regard this different emphasis as merely a variation upon a theme; their present position was broadly included in contentions before the district court.[9]

Recognizing, as this court has done so frequently, the deference to be accorded interpretations by an agency of its own regulations when not plainly erroneous, Udall v. Tallman, 380 U.S. 1 (1965), the district court stated:

> It is the opinion of the court that DOE's interpretation requiring a weight-averaging of the sales

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[9] Appellants described in the district court their theory for calculating natural gas shrinkage as follows:

> In losing that opportunity [to sell the shrinkage volume as natural gas], the gas processor forfeits the revenues he could have obtained by selling the shrinkage volume as gas. The actual cost of this lost opportunity can appropriately be measured only by ascertaining the price at which the *additional, incremental volumes* of gas would have been sold if not used up to make the liquids—i.e., the true opportunity cost, sometimes referred to as the "incremental cost." To put it more concretely, the actual value of shrinkage can only be determined by looking to *relevant* prices (those at which the shrinkage volumes could have been sold) and eliminating all *irrelevant* prices (those at which the shrinkage volumes would *not* have been sold). [Footnote omitted] [Emphasis in original.]

R. 2799.

of residue gas under all existing contracts during the current month, including existing long-term, fixed-price contracts, for purposes of determining cost pass throughs to NGL prices is neither plainly erroneous nor contrary to the regulatory language and should be given deference.

582 F. Supp. at 915-16.

The validity of Chief Judge Woodward's reasoning, which we need not here recite in detail, becomes even more apparent upon further analysis of appellants' "opportunity costing" concept.

"OPPORTUNITY COST" AS THE "ROOT CONCEPT"

Texaco uses for the caption of its related argument the phrase "Opportunity Cost—The Root Concept," asserting that in spite of a general acceptance of the opportunity costing principle in Subpart K, and in its interpretations, DOE's position has become "one of rejecting opportunity costing itself." [10]

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[10] Opportunity Cost—The Root Concept

The dominant theme of DOE's brief is its persistent failure to embrace and accord recognition to the opportunity cost concept which lies at the heart of the shrinkage principle. It is accepted by all parties that the Subpart K shrinkage provisions embody an opportunity cost concept. *See MGPC Inc.*, 11 DOE § 83,009 at p. 86,080 (1983) (" 'opportunity cost' . . . is at the root of allowable shrinkage costs"); *Placid Oil Co.*, Interpretation 1979-2M, 44 Fed. Reg. 39376, 39378 (1979). DOE admits as much in its brief here, just as it did in the court below. *See* DOE Br. 15 ("the FEA decided to use an 'opportunity cost' concept to define NGL product costs"); R. 4339. Moreover, DOE explicitly recognizes that an opportunity cost "*by definition* converts anticipated [lost] *revenue* (including profit)" into a cost. DOE Br. 5, n. 4 (first emphasis added). Yet throughout its brief DOE steadfastly refuses to accept and apply *its own definition of its own concept.* Ultimately, DOE's position becomes one of rejecting opportunity costing itself. [Footnote omitted.] [Emphasis in original.]

Texaco's Reply Br. at 1.

In a broad sense the very idea of shrinkage as an element of product cost must be based upon "opportunity" rather than actuality to be meaningful. "Shrinkage" itself ceases to exist as it occurs. The opportunity to sell the hydrocarbons lost through shrinkage would also be lost—indeed was—unless in the regulatory plan some substitute for it could be recognized as an element of product cost in pricing the residue. In this sense, "lost opportunity" was basic to Subpart K.

But to stretch this concept to control not only the allowance of shrinkage for costing purposes, but also its measurement, contrary to the regulatory language establishing a specific standard for the latter purpose, is quite another thing. Examination of appellants' references demonstrates that the concept of lost opportunity cost does not necessarily control the quantification of shrinkage, as distinguished from its allowance, and cannot do so in view of the language of the regulation.

MGPC, Inc., 11 DOE ¶ 83,009 (July 22, 1983), *supra*, held among other things that "the use of the residue gas sales price received by MGPC," despite complications in connection with the "one firm" rule, was consistent with the notion of opportunity cost which "is at the root of the allowable shrinkage cost." We do not assume to pass upon the validity of that particular ruling. We recognize that in some such contexts the allowance and measurement of shrinkage elements may almost merge. But we see nothing to support appellants' contention that surplus contracts under which sales have not been made during the month of measurement can provide the sole basis for calculating shrinkage pursuant to Subpart K. On the contrary, the decision refers basically to Ruling 1975-6 as a statement of the weighted-average price rule contemplated by Subpart K, and to the language of 10 C.F.R. § 212.162 dealing with "contracts in effect at the time for which natural gas shrinkage is being measured and under which the processed natural gas is sold." Rul-

ing 1975-6 had determined among other things that "the cost of shrinkage shall be determined by comparing the value of natural gas prior to processing with the value of the natural gas after processing" and that "[t]he value of the natural gas stream for this purpose shall be computed by reference to the contractual terms in effect for the sale of . . . 'residue' natural gas during the relevant month." 40 Fed. Reg. 23272, 23273-4.

Far from supporting the plaintiff's position, *Placid Oil Company* Interpretation 1979-2M, 44 Fed Reg. 39376 (1979), related the expression "increased shrinkage 'costs' " as compensation for "lost opportunities" to the allowance of shrinkage as a product "cost" rather than to its "measurement," clearly differentiating the two matters.[11]

The agency concluded on this point in language especially instructive here:

> While the opportunity costs described as increased shrinkage costs are the equivalent of increased prod-

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[11] Thus, increased shrinkage costs are designed to permit recoupment in NGL prices of the reduction in sales revenue resulting from the contractual price terms in the relevant month for that residue gas.

Increased shrinkage "costs" are a compensation for lost opportunities, i.e., opportunities to sell the natural gas without extracting the liquid content of the "wet" stream.

This opportunity cost is measured "by reference to the contractual terms in effect for the sale of [the firm's] 'residue' natural gas during the relevant month". . . . Subpart K now imposes the same general requirements for measuring shrinkage costs in § 212.166 which states in pertinent part:

> "Cost of natural gas shrinkage" means the reduction in selling price . . . *as determined pursuant to the contract in effect at the time for which cost of natural gas shrinkage is being measured, and under which the processed natural gas is sold.* [Emphasis in original.]

44 Fed. Reg. 39378.

> uct costs, such "costs" do not represent outlays of dollars and therefore cannot be recouped on an exact dollar-for-dollar basis. *Kansas-Nebraska Natural Gas Co.*, Interpretation 1978-41, 43 FR 29548 (July 10, 1978). Section 4(b)(2)(A) of the EPAA does not require that Placid be permitted to impute a value in dollars on residue gas not sold, which value may then be employed in shrinkage calculations.
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> . . . [I]ncreased shrinkage costs are recognized for cost computation and allocation only when the gas sales revenues due to extraction are lost, i.e., when the residue gas is sold. Prior to that time, there is no guarantee that the gas will be sold and that a firm will incur any lost opportunity cost.

44 Fed. Reg. 39378.

In the *Kansas-Nebraska* Interpretation, *supra*, the distinction between allowance of opportunity costs and their measurement was painstakingly explained by the agency.[12]

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[12] While the opportunity costs described as increased shrinkage costs are the equivalent of increased product costs, such "costs" do not represent outlays of dollars and therefore literally be recouped on a dollar-for-dollar basis. Furthermore, the implicit extension of Kansas Nebraska's position is that all opportunity costs associated with the production of covered products must be recovered on a dollar-for-dollar basis. Such general application of § 4(b)(2)(A) would arguably render unlawful any price limitations preventing the opportunity to sell covered products at a price reflecting the "free market value" of the covered products in relation to unregulated products or activities theoretically available to the processor. Such a result would mean that the products generally must be priced at their current market value, a result incompatible with the very existence of price controls. . . . The Company argues that the method specified for calculating shrinkage costs, the "per Mcf" approach, will not always exactly coincide with the total gas sales dollar revenue foregone. Nevertheless, the fact that the method of valuing costs is not as precise in individual cases as could be formulated does not mean that the valuation method violates the dollar-for-dollar passthrough requirement.

43 Fed. Reg. 29550 (July 18, 1978).

The distinctions thus drawn and the principles applied were consistent with Ruling 1975-18, 40 Fed. Reg. 55863 (Dec. 2, 1975), which recognized in the year Subpart K became effective that the controlling weighted average applied to volumes of natural gas subject to differing sales contracts and that the residue price to be used to determine the cost of natural gas shrinkage, without reference to any broader "opportunity cost," was a weighted average of all the contract price terms under which the different volumes of processed natural gas were sold.

That DOE has conceded opportunity costing is at the root of allowable shrinkage and that the agency decided to use an "opportunity cost" concept to define NGL product costs thus is understandable. But the claimed further admission ascribed by Texaco to DOE "that an opportunity cost by definition converts anticipated [lost] revenue (including profits) brief into cost," is not warranted by citation in DOE's brief. In substance DOE said quite the contrary with *ad absurdum* emphasis.[13]

PLAIN LANGUAGE

The definition of "cost of natural gas shrinkage" in Subpart K bases measurement of shrinkage upon a "contract in effect at the time for which cost of natural gas shrinkage is being measured, and under which the processed natural gas is sold." 10 C.F.R. § 212.162, *supra*.

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[13] If a firm could "sell" propane (or any refined product) to itself at "market value," the entire cost-based price control system would be nullified. If "market value" became the measure of a firm's cost, then the firm's maximum lawful price would always exceed market value; an "opportunity cost" by definition converts anticipated *revenue* (including profit) into a fictitious "cost," so that maximum lawful prices based on costs may be bootstrapped upward without limitation.

DOE br. p. 5 n. 4.

This language plainly means that if there were a fixed-quantity contract in effect at the time of measurement under which the residue gas was sold it would have to be considered, along with any other outstanding contracts under which gas was sold during the measurement period in determining the cost of natural gas shrinkage. In our opinion, it would be an unreasonable construction, despite use of the singular, to say that in the case of several effective contracts only one would be considered as the rule provides, and another in the same situation disregarded.[14] Even plainer would be rejection by the language used of any idea that the contract to be disregarded was the one under which gas was sold during the month of measurement and a contract under which gas was not sold during the month of measurement was the one to be given controlling effect in the measurement of shrinkage.

Appellants argue that only their surplus contracts and not the fixed-quantity contracts under which gas was sold during the measurement period satisfied the criteria of subsection 162.[15] In rejecting this argument, the district court observed:

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[14] The preamble to Subpart K itself rejects any such notion for it refers to contracts in such context:

> The cost of shrinkage shall be computed based upon the contractual terms in effect for the sale of natural gas during the time period for which shrinkage cost is being measured. Thus, in those cases where the natural gas processed is or was sold under contracts at prices based on BTU value, the cost of "shrinkage" is to be computed based on the reduction in sales revenues from natural gas because of reduced BTU value attributable to gas processing, and where the natural gas processed is or was sold under contracts at prices based on the volume of gas, the cost of "shrinkage" is to be computed based on the reduction in sales revenues from natural gas sales because of reduced volume attributable to gas processing.

39 Fed. Reg. 4409, *supra*.

[15] DOE asserts (br. pp. 20-22) that neither Texaco nor Exxon actually had any "surplus" contracts in effect under which they

> When there are outstanding contracts—fixed quantity or otherwise—and a stream of gas enters a plant for processing, part of the BTU content that could conceivably have gone toward satisfaction of those existing contracts is lost. In other words, the loss of revenues from processing actually pertains to *all* the existing contracts. Plaintiffs' theoretical attribution of the loss of revenue due to processing exclusively to surplus contracts is spurious; it is merely a rationalization for charging the highest price possible. [Emphasis in original.]

582 F. Supp. at 934.

The language of the regulation will not accommodate appellants' theory. The district court was quite right in determining that the agency's interpretation requiring a weighted average of sales of residue gas sold under all existing contracts during the current month, was not clearly erroneous or contrary to the language of the regulation. 582 F. Supp. at 934, 937. It would seem that such a construction is essentially compelled, but even were this not so, agency interpretations to this effect, being consistent with the language of the regulation, would be entitled to special deference on the record before us. Udall v. Tallman, 380 U.S. 1, 16-17 (1965); Pennzoil Co. v. United States Dept. of Energy, 680 F.2d 156, 168-171 (Em. App. 1982), *cert. dismissed*, 459 U.S. 1190 (1983).

FORMAL AGENCY INTERPRETATIONS

Ruling 1975-18, issued in December 1975, set out DOE's position with respect to the weighted-average method of calculating shrinkage costs, in agreement with the language of the regulation itself and in harmony with DOE's litigation position in this case:

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could have sold the surplus gas lost in processing. However, both Texaco and Exxon take the position on appeal that they did have such contracts. For purposes of this decision we will assume that they did.

> The purpose of requiring a "weighted average" cost comparison is to provide a method by which firms which have chosen, pursuant to § 212.167(b), to aggregate the total amount of increased product costs respecting volumes of natural gas subject to differing sales contracts which are processed in one or more plants, may calculate a single amount representing the increased costs of natural gas shrinkage for the aggregate of volumes of natural gas processed. Accordingly, the above formulae provide the acceptable methods for the computation of a "weighted average cost of natural gas shrinkage." Where the increased costs associated with several volumes of processed natural gas have been aggregated, the residue price which is used to determine the cost of natural gas shrinkage is a weighted average of all contract price terms under which the different volumes of processed natural gas are sold.

Ruling 1975-18, 40 Fed. Reg. 55860, 55863 (December 2, 1975).

Exxon contends that this ruling did not address a situation where there were one or more "irrelevant" contracts. Again, this argument erroneously assumes that fixed-quantity contracts were irrelevant in determining shrinkage, which was precisely the issue upon which the trial court ruled against appellants and in our opinion correctly.

Texaco argues that section 212.167, interpreted by Ruling 1975-18, "does not address the basic calculation of the cost of shrinkage but pertains instead to a company's option to aggregate shrinkage costs separately calculated for different streams." It is true that subsection 167 does not itself mention "residue prices" but speaks in terms of "the weighted-average cost of natural gas shrinkage." However, Ruling 1975-18 does explicitly refer to the "residue price" used to determine natural gas shrinkage and defines it as "a weighted average of all the contract price terms under which the different volumes of natural gas are sold."

Appellants contend that two other formal agency interpretations do support their opportunity costing method and reject the weighted-average method of calculating shrinkage costs. We believe that these later interpretations, *Sun Gas Company* Interpretation 1978-37, 43 Fed. Reg. 29543 (July 10, 1978), and *Kansas-Nebraska* Interpretation 1978-41, 43 Fed. Reg. 29548 (July 10, 1978), were only tenuously in point and that they do not support appellants' position essentially for the reasons stated by Judge Woodward, 382 F. Supp. at 916-17. We would emphasize that in reaching its conclusion in the peculiar circumstance of the Btu adjustment contracts involved, the agency in *Kansas-Nebraska* expressly rejected the fundamental premise underlying appellants' position, as we have already pointed out in differentiating the allowance of shrinkage from its measurement in accordance with Subpart K.

We have considered, although we are not persuaded to the contrary by, the arguments set out in Exxon's "Post-Argument Correction of Misstatement of Fact [by DOE in oral argument]," DOE's response and Exxon's reply. Exxon there complains that DOE's counsel stated that during the relevant period Exxon had not been selling gas "pursuant to a contract that provided a higher price for additional gas that would have been available in the absence of processing." We have already indicated that for the purposes of our decision we have rejected such suggestion since it would involve a contested factual situation and in our view would be immaterial to the validity of the judgment under review. The district court decided that Subpart K required the processor to weigh average prices for residue gas sold under all contracts in effect, including surplus as well as fixed-quantity contracts, during the month of measurement, 582 F. Supp. at 934, and that is our view.

In a given month an appellant may have sold a particular quantity of residue gas under a surplus contract at

a price higher than that at which residue gas was sold during the same month under a lower-priced, fixed-quantity contract, and the decision below permitted sales prices for all residue gas sold during the month of measurement to be weight averaged in accordance with the regulation. However, to count in this weight-averaging process not only the quantity of gas actually sold under surplus contract, but the additional quantity which appellants argue could have been sold at the higher price had it not been lost through shrinkage, would be in conflict with the plain language of the regulation. Another contention included in Exxon's submission following oral argument in this court that DOE had admitted its case away in the course of that argument is not persuasive.[16]

INFORMAL INTERPRETATIONS BY DOE PERSONNEL

Appellants contend that the district court erroneously discounted informal agency advice tending to support their present position, including an "incremental costing letter" to Texaco from Larry White, DOE's Regional Director of Compliance for Region VI, the "Janowski Memorandum" and "Clarification 78-3." Only one of these writings bears sufficiently on the point at issue to warrant further comment.[17]

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[16] Exxon seizes upon a statement by DOE's counsel that "[t]he plaintiffs are correct in their description of *Kansas-Nebraska*.

It was obvious that DOE's counsel in accepting appellants' "description" of *Kansas-Nebraska* had reference to the context of the Btu adjustment clause dealt with there as it had been referred to in the oral argument of opposing counsel and on the basis of which DOE's counsel proceeded to distinguish the facts involved in that decision and the present case.

[17] This letter among other things stated:

> The information identified as "Case 2" is an example of Texaco's proposed method of "incremental pricing" in the calculation of increased shrinkage costs. In principle, we

Texaco asserts that the White letter was "authorized" by the Office of the General Counsel, but the record does not bear this out. The letter itself indicates that for an authoritative answer resort would have to be had to the Office of the General Counsel. This presents a *Pennzoil* situation [18] of little or no significance under the circumstances of the present case. Beyond the oil company's general knowledge of the regulation requiring resort to the General Counsel's Office as in *Pennzoil*, the very communication on which appellants rely expressly cautioned against any reliance.

The trial court was correct in ruling that Texaco had no reasonable basis to rely upon informal comments of

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allow for audit purposes a "cost of shrinkage" value which is equal to the revenues lost in residue gas sales because of the extraction of natural gas liquids. Realizing that this principle parallels your position, we do not anticipate at this time taking exception to the principle of your second, or proposed method of calculating shrinkage for your Floodway and Paradis plants on a prospective basis. . . . Please be advised that our acceptance of the principles expounded in your second method is based on information provided by you and is subject to change based on additional facts or further clarification. In order for you to have complete reliance on FEA's position, you must file a request for interpretation to the Office of General Counsel and we suggest that you immediately request such an interpretation. Therefore, this letter should not be construed to be an interpretation, ruling, or official position of FEA, but rather should be viewed solely as a statement of the manner in which the provisions of 10 CFR 212, Subpart K, are currently applied in our audits of natural gas processors.

White to Texaco, May 17, 1977.

[18] [The Oil Company] knew from the regulations themselves that only an official interpretation by the General Counsel's Office could furnish any assurance for its new course; it chose not to request one.

Pennzoil Co. v. United States Dept. of Energy, 680 F.2d 156, 179 (Em. App. 1982), *cert. dismissed*, 459 U.S. 1190 (1983), *supra*.

agency personnel and that DOE was not estopped from challenging Texaco's shrinkage calculations.[19]

ARBITRARY AND CAPRICIOUS CONTENTION

Appellants contend that if DOE's weighted-average price methodology is to be given effect, the disputed provisions of Subpart K must be invalidated as arbitrary and capricious.

They allege that the weighted-average method conflicts with the agency's stated purpose in promulgating the shrinkage regulations, *i.e.*, to preserve economic incentive to extract NGLs by allowing a dollar-for-dollar pass-through of increased costs. The district court appropriately rejected the latter contention on the basis of the rationale expressed in the quotations from the *Kansas-Nebraska* Interpretation set out in footnote 12, *supra*. A related contention that the district court failed appropriately "to apprehend" some violation of regulatory purpose that would result from "rigid" adherence to the average price method is without merit.

Texaco claims in the alternative that if the court sustains DOE's interpretation of Subpart K, the regulation should be invalidated on the ground that it failed to take into account, beyond the required objectives of the mandatory price regulations enumerated in the EPAA, other relevant factors which the merits of appellants' incremental costing system are claimed to have invoked.

The preamble to Subpart K as quoted in our summary of the regulatory history itself demonstrates a proper

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[19] The estoppel issue was properly before the district court on Texaco's motion for new trial and defendants' cross-motion for summary judgment on all issues raised in the plaintiffs' joint amended complaint. Texaco's contention that it never received DOE's motion is unpersuasive in light of its admitted receipt of the briefs on the motion, its attendance at the oral hearing thereon and its failure to complaint about lack of service of the motion until reaching this court.

balancing of the objectives the agency was mandated to consider. Nothing appears to the contrary. Basin, Inc. v. Federal Energy Administration, 552 F.2d 931, 935 (Em. App.), *cert. denied*, 434 U.S. 821 (1977); Amtel, Inc. v. Federal Energy Administration, 536 F.2d 1378, 1383, n.9; Pasco, Inc. v. Federal Energy Administration, 525 F.2d 1391, 1397 (Em. App. 1975). *Cf.* Mobil Oil Corp. v. Dept. of Energy, 610 F.2d 796 (Em. App. 1979), *cert. denied*, 446 U.S. 937 (1980), deemed inapposite to the circumstances of the present case.

But Texaco would bypass the apparent consideration and balancing by the agency of the objectives of the Act, and concentrate upon the assumed reasonableness of its own incremental costing dismissing fixed-quantity contracts as irrelevant. Upon such a premise, it charges the agency with having failed to consider, or even to be "aware" of, the existence of fixed-quantity contracts in the industry. The regulatory history that we have summarized militates against both the assumption and the conclusion. Texaco's argument is based upon an erroneous view of the regulation in supposing that it differentiated between sales made under existing contracts during the month of measurement depending on whether they were in satisfaction of surplus or fixed-quantity contracts. Its reliance upon two cited cases is misplaced.[20] Neither of

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[20] Bowman Transp. v. Ark.-Best Freight System, 419 U.S. 281 (1974), while recognizing that a court reviewing an administrative determination must consider whether the administrative decision was based on an evaluation of the relevant factors and whether there has been a clear error of judgment, notes that it must limit itself to a very narrow scope of review under the "arbitrary and capricious" standard. Motor Vehicle Mfr's Assn. v. State Farm, —— U.S. ——, 103 S.Ct. 2856 (1983), held that the revocation of a safety standard for automobiles requiring safety restraints was arbitrary and capricious because it was not coupled with a consideration of significant relevant factors, but cautions against any assumption that an agency is required to consider all possible alternatives in reaching its decision.

them deals with a comparable situation, but both recognize principles which weigh against appellants' contention that Subpart K as construed by the district court is arbitrary or capricious in any respect.

SUBPART E [21]

In making clear in Ruling 1975-6, *supra*, "that increased costs of natural gas shrinkage could be passed through as increased product costs pursuant to the provisions of Subpart E. . . .", the agency conceded that it "never [had] made very clear how the price rules of Subpart E, which did not specifically address the activity of natural gas producers and processors, should be construed in their application to such activities." 40 Fed. Reg. 23320 (May 29, 1975). Nor did the agency in that ruling define the method for calculating shrinkage during the Subpart E period as we have already recognized. Twin City Barge & Towing Corp. v. Schlesinger, 603 F.2d 197, 200 (Em. App. 1979). Accordingly, the district court considered whether alternative methods utilized or contended for by appellants were reasonable under the circumstances. *See* Standard Oil Co. v. Department of Energy, 596 F.2d 1029 (Em. App. 1978). The district court determined that they were not. The parties here are agreed that the issue before us is essentially one of reasonableness.

Exxon contends that its intrafirm "transfer pricing" method, derived through the use of the firm's "historical accounting procedures" by analogizing the raw material costs of crude oil to natural gas, was a reasonable method to calculate the "increased cost of NGLs" prior to January 1, 1975. In the alternative, the appellants contend that they were entitled to recalculate the increased cost of NGLs based on their theory of "incremental increases in value of natural gas shrinkage."

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[21] 10 C.F.R. §§ 212.81, *et seq.*

The district court held that to the extent the refiners were assigning prices on intrafirm transfers of natural gas liquids based on factors other than actual increases in the cost of natural gas liquid products, the practice was unreasonable and not in accordance with Subpart E, in the light of Subpart K and Ruling 1975-6; that appellants' incremental costing method for computing shrinkage was unreasonable for the Subpart E period, and that during that period appellants were entitled to compute product costs in the evaluation of shrinkage in accordance with the weighted-average method confirmed by the court.

We affirm the district court's ruling with respect to Subpart E, essentially for the reasons well stated by Judge Woodward, 582 F. Supp. 920-21, 930-34.[22]

ETHANE EXCLUSION RULE—ESTOPPEL

The ethane exclusion rule included in Subpart K by application of a V-factor required natural gas processors to allocate substantial shrinkage costs to lower-value ethane which was exempt from price controls and thus proportionally decrease costs assigned to other NGLPs—

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[22] *Cf.* Gulf Oil Corp. v. Department of Energy, 671 F.2d 485 (Em. App. 1982), which held that Subpart K in effect provided that the transfer of NGLs and NGLPs by gas processor-refiners to affiliated marketers constituted "first sales" within the contemplation of that subpart and that the limitations with respect to sales to affiliate entities in Subpart E had not been carried forward into K. While not asserting that this case was literally inconsistent with the district court's decision here, Exxon's counsel in oral argument suggested that its importance had not been developed sufficiently in the briefs, and contended that the district court's reasoning had thrown into question the validity of its weight-average construction by emphasizing the importance of (1) regulatory language, (2) regulatory purpose and history, (3) contemporary construction and (4) basic fairness. It already must be sufficiently evident from what we have said in the foregoing discussion that we believe the method upheld by the district court amply met these tests in the case now before us.

propane, butane, and natural gasoline—which had a higher thermal content and market value and which were subject to controls.

While the district court summarized the various arguments on the validity or invalidity of the related rulemaking and the rule itself, it decided none of the issues posed thereby in view of its holding that the "transfer" of the rule from its crude oil context in Subpart E to the natural gas liquids context of Subpart K was invalid apparently by reason of some *res judicata* or collateral estoppel effect of Mobil Oil Corp. v. Department of Energy, 610 F.2d 796 (Em. App. 1979), *cert. denied*, 446 U.S. 937 (1980), *supra*.[23]

This holding cannot be resuscitated, as appellants would have us do, by a rationalization that the district court really meant merely that our prior decision was controlling in principle or upon its reasoning or, as counsel for Exxon puts it, because of "functional equivalency." In the former case there was a complete failure of notice in advance of the promulgation of the regulation and a conceded failure of the agency to consider objectives mandated by the governing statute and the oil

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[23] Although DOE may be correct in its position that at the time the ethane exclusion was promulgated, it considered that its action was only a "technical transfer" which required no further notice and opportunity for comment, the "transfer" was of the provision which has been conclusively determined to have been null and void, procedurally and substantively. It would be unreasonable to find that the transfer to a new subsection gave the provision new life. The ethane exclusion provision has, in effect, been determined by a final decision of TECA to be invalid, and this court cannot find to the contrary.

DOE's contention that the doctrine of laches prevents any judgment on behalf of the plaintiffs on the ethane exclusion is rejected. Laches is not available as a defense where, as here, the regulation in question has been ruled null and void.

582 F.Supp. at 925.

company was in defensible litigious posture. Here the equitable position of the appellants is exceedingly infirm and the record supports rather than conclusively negates the validity of the rulemaking with which we are now concerned.

In expansive deference to our prior decision and upon the basis of a simplex contention by DOE that transfer of the V-factor to Subpart K was a mere technical amendment which did not require notice and opportunity for comment, the trial court understandingly fell into error.[24]

The district court's summary rejection of DOE's laches defense on the ground that it was not available in a situation where the regulatory provision already had been ruled null and void by this court suffered from similar infirmity.

The question remains whether, in necessarily reversing, the case should be remanded for its reconsideration of

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[24] DOE did not contend in the district court, nor does it maintain here, that no new rulemaking whatsoever was required and thus not carried out. *See, e.g.*, DOE's express denial of the allegations of the appellants' Joint First Amended Complaint that the volumetric apportionment rule did not appear in the proposed Subpart K, that the agency provided no prior notice or opportunity to comment, and that the agency did not consider relevant factors, R. 1256-7, 1269. There was a mechanical transfer of the new proposed rule from its original location in Subpart E to K. The propriety of this latter transfer becomes obvious from our review of the rulemaking leading up to it. But before that transfer there was notice given which DOE contended before the district court "was sufficient to place the industry upon notice that the agency would continue all existing rules under Subpart E, including the V-factor which required volumetric allocation of increased product costs to ethane and other exempt products," and this contention was noted by Judge Woodward at the time he made his decision and was rejected in view of his erroneous holding that our prior decision precluded him from considering it. 582 F.Supp. at 924-25.

the issues of laches and the substantive and procedural validity of the rule or in the interest of judicial economy decided on this appeal as a matter of law. While we have concluded that DOE's laches defense is dispositive, it can better be evaluated in the light of some additional regulatory history. The general regulatory history reviewed at the outset of this opinion, and the description of the V-factor as it existed in the crude oil context in April 1974, as referred to in and invalidated by *Mobil*, 610 F.2d at 799-80, are sufficient to bring us up to August 9, 1974, in a more particularized review of developments relating to the ethane exclusion rule.

On the last-mentioned date the agency modified the Special Propane Rule to exclude from the price of propane not only the costs attributable to ethane but costs attributable to any other refined product. Emergency Amendment to Special Propane Rule, 39 Fed. Reg. 28608-09 (August 9, 1974). A conforming amendment was made to the V-factor later that month. 39 Fed Reg. 30828 (Aug. 26, 1974). Shortly thereafter Congress determined in section 5(b)(ii) of the Federal Energy Administration Act of 1974, that it would be "equitable" for the FEA to allow only costs directly related to propane production to be allocated to propane. The agency adhered to this principle in promulgating the Subpart K cost allocation provisions for NGLPs.

On September 10, 1974, the FEA issued a notice of proposed rulemaking with respect to the new Subpart K, as noted in the regulatory history before recited. The proposals included modification of the refiner rules contained in Subpart E to restrict the amount of increased product cost allocable to special products and to authorize the allocation of increased costs to whichever covered products refiners desired. In view of the introduction of the new natural gas shrinkage concept, the agency proposed also a passthrough of such increased cost upon a

basis analogous to the passthrough of increased costs of refined crude oil. 39 Fed. Reg. 32720 (Sept. 10, 1974).[25]

Comment was particularly invited as to whether the Special Propane Rule should be extended to cover butane and natural gasoline. 39 Fed. Reg. at 32720. The inclusion of butane and natural gasoline within the Special Propane Rule would have operated to prohibit the allocation of costs associated with ethane to the other three products, because only four basic NGL products were produced at gas plants—propane, butane, natural gasoline and ethane.

In the course of the rulemaking, the agency decided that in order to make Subpart K "as simple and understandable as possible," 39 Fed. Reg. 44407 (Dec. 24, 1974), independent gas processors should be taken completely out of Subpart E, with the simplified rules of Subpart K to control all of their activities, while crude oil refiners would remain subject to the provisions of Subpart E. This necessitated the adoption of some of the provisions of Subpart E for use in Subpart K, including a V-factor as it related to ethane, the only exempt product involved in natural gas processing. Thus, an ethane exclusion rule was included in the new Subpart K at section 212.147, codified in 10 C.F.R. 212.167(a), later renumbered 212.168(a).[26]

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[25] The proposed § 212.144, "Application of increased costs," included the following statement: "Any firm which incurs increased product costs or increased non-product costs with respect to processing or fractionating natural gas liquids in a particular plant may pass such costs through, in accordance with the cost passthrough provisions for increased costs of Subpart E. . . ." 39 Fed. Reg. 32730 (Sept. 10, 1974).

[26] This modified V-factor as adapted in Subpart K was thus defined:

§ 212.167 Allocation of increased product costs.

(a) Exclusion of increased product costs attributable to ethane. The total amount of increased product costs attributa-

In the notice of proposed rulemaking, the agency had stated that the Special Propane Rule was subject to comment and testimony in this proceeding, "and is also a part of the FEA proposal for passing through increased costs of processing natural gas liquids. . . ." 39 Fed. Reg. at 32720. Refiners had been advised of the breadth and interrelationship of the proposals in the published notice of proposals.[27]

The Subpart K preamble reiterated this relationship between the allocation of costs of producing propane and the other natural gas liquid products:

> A principal aspect of the regulations adopted today is that they serve to allocate costs of producing propane and other natural gas liquid products to the prices which may be charged for those products, consistent with the provisions concerning propane price

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ble each month to a given volume of natural gas shall be reduced each month by an amount equal to the product of the increased product costs multiplied by

$$\frac{(Ve^u)}{(V^u)}$$

where:

V^u = The total volume of all natural gas liquid products and ethane derived from that volume of natural gas and sold in the current month, and

Ve^u = The total volume of all ethane derived from that volume of natural gas and sold in the current month.

[27] The FEA price regulations are complex and interrelated. Many of the specific proposals made herein affect various other aspects of these regulations. The nature and extent of the revisions being proposed in this notice of rulemaking are quite broad. . . . Also, depending on the nature of the comments received in this proceeding, certain proposals in this notice may be placed into effect more quickly than others, although the objective is to have all these proposals placed into effect as soon as possible. It may well develop, however, that certain proposals will evoke comments and will require more extensive analysis than others.

39 Fed. Reg. 32725 (Sept. 10, 1974).

regulations of § 5(b)(11) of the Federal Energy Administration Act of 1974 (Pub. L. 93-275).

This record indicates to us that appellants were reasonably on notice during the Subpart K rulemaking that a V-factor was being considered for ethane.[28] But certainly they had full knowledge of the form as well as substance of the ethane exclusion rule when Subpart K was published on December 24, 1974. Their acquiescence in the operation of that rule and their failure to take any action to question it until July 1981, clearly sustain DOE's defense of laches against appellants' attack upon the rule in view of the uncontroverted record before us. *See* Mobil Oil Corp. v. Dept. of Energy, 728 F.2d 1477, 1487-89 (Em. App. 1983); Independent Bankers Ass'n

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[28] Administrative regulations are presumed to be valid and entitled to deference in the absence of some showing to the contrary or some inherent unreasonableness. Specific and final formulations of noticed subject matter are not required in advance if the path of the agency is reasonably discernible in the rulemaking, practical considerations and the simplicity of administration are not irrelevant, and recitals by rote of mandated statutory objectives, or alternative or variations, are not the hallmarks of sufficient rulemaking where the substance of full, fair and rational consideration appears. Mobil Oil Corp. v. Department of Energy, 728 F.2d 1477 (Em. App. 1983); McCulloch Gas Processing v. Dept. of Energy, 650 F.2d 1216 (Em. App. 1981); Texaco, Inc. v. Federal Energy Administration, 531 F.2d 1071 (Em. App.), *cert. denied*, 426 U.S. 941 (1976). *Cf.* Mobil Oil Corp. v. Department of Energy, 647 F.2d 142, 144, n.6 (Em. App. 1981), and Mobil Oil v. Dept. of Energy, 610 F.2d 796, 805 (Em. App. 1979), *cert. denied*, 446 U.S. 937 (1980), in which we sustained attacks against certain V-factor regulations for other reasons, but indicated no view that there was anything inherently unreasonable in the volumetric allocation of product costs and, indeed, mandated adherence to an intervening congressional direction that in specifying prices or prescribing the manner for determining them, the agency "shall not permit more than a direct proportionate distribution (by volume) to [certain named special products] and propane produced from crude oil, of any increased costs of crude oil incurred by a refiner. . . ." *See* 15 U.S.C. § 753(b)(2)(D), incorporating a provision of the Energy Policy and Conservation Act amending in 1975 the EPAA.

of America v. Heimann, 627 F.2d 486 (D.C. Cir. 1980). *Cf.* Energy Co-Op, Inc. v. U.S. Dept. of Energy, 659 F.2d 146, 150 (Em. App. 1981).

Soon after Subpart K was promulgated, Mobil Oil, initially one of the parties to this consolidated appeal, requested the agency to change the ethane exclusion formula to allocate costs on a Btu rather than a volumetric basis. Mobil then made no claim of any procedural defect nor did Exxon or Texaco assert objection to the ethane exclusion rule at all. Indeed, none of them did so until 1981, following the expiration of DOE's authority to either issue or amend any regulations for the correction of defects to the extent they may have existed.

Even more clearly indicating acceptance of the validity of the ethane exclusion rule, Exxon in the initial attack upon Subpart K, specifically limited its objections to the shrinkage provision and directly related aspects and made no reference either in form or substance to the ethane exclusion rule.[29] In June 1979, Mobil success-

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[29] Exxon's complaint filed July 8, 1975, stated:

> This lawsuit contests the authority of the defendants to control the prices of natural gas liquids (NGLs) and challenges the method for determining the base period and current values of natural gas liquids for the purpose of passing their increased costs through to the finished products made from them. [R. 2.]

It specifically attacked shrinkage as "[t]his new method of valuation substantially [reducing] the value for costs purposes of the NGL's Exxon producers and does not represent their true value." R. 6. Its closing allegations summarize the basis of its complaint in terms of the FEA's having provided this "new method of valuation" without prior notice or public comment, making it retroactive by Ruling 1975-6, the effect of this ruling being to deprive Exxon of substantial costs, causing to Exxon substantial lost revenues caused by both the method of valuation in Subpart K and Ruling 1975-6, and stating the reasons why it claimed the "actions are contrary to law and should be set aside," R. 7, none of which touch upon the ethane exclusion rule. It is ironical that at that time Exxon saw in Subpart K and Ruling 1975-6 this objectionable "new rule on

fully sought to intervene in the present litigation. It made no mention of the ethane exclusion rule either expressly or by implication. Some two years later it did file a motion to amend its complaint to allege that the shrinkage provision was procedurally infirm, still not questioning the ethane exclusion rule.

On May 22, 1981, Mobil filed an amended complaint raising for the first time a question concerning the validity of the ethane exclusion rule and almost two months later the present appellants joined with Mobil in a "Joint First Amended Complaint of Refiner Plaintiffs" repeating Mobil's formulation of an attack upon the rule on substantive and procedural grounds.

Appellants respond to the untimeliness of this wholly new claim so suddenly emerging from the sea of different controversy with the contentions that their complaints in their declaratory judgment action were "defensive" in view of DOE's enforcement actions elsewhere thus rendering the doctrine of laches inapplicable, although appellants do not contend that the enforcement actions directly involve the validity of the ethane exclusion rule,[30] and

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shrinkage," but now perceives in it nothing inconsistent with appellants' own "incremental cost" interpretation of the shrinkage provision.

Texaco first sought to intervene on Feb. 23, 1979, limiting its interest to the shrinkage provision and thus explaining its delay in attacking those provisions: "Until shortly before January 5, 1979, when DOE first challenged Texaco's shrinkage computation for NGL's, Texaco did not have a dispute with DOE over such computation. Accordingly, Texaco has timely sought to intervene here." R. 672.

[30] DOE has represented that the complaints in the enforcement actions do not charge appellants with failure to apply the ethane exclusion rule and that at the present time it has no evidence that they did not comply with that rule. The appellants' only rejoinder is that they have been charged with the "overpricing of propane,

that in any event DOE has demonstrated neither inexcusable delay nor prejudice as foundations for appellants' laches claim. The only excuse they tender for the delay is the untenable assertion that their attacks against Subpart K prior to 1981 were broad enough to challenge the ethane exclusion rule.

The appellants waited until after decontrol to raise their challenge, when it was too late for the agency to attempt to adjust the regulatory system should the challenge have been successful. It is reasonable to infer from the record that most if not all other refiners routinely complied with the rule as promulgated and that possibly billions of dollars were allocated by them to exempt ethane.

In Mobil Oil Corp. v. Department of Energy, 728 F.2d 1477, 1489 (Em. App. 1983), *supra*, Judge Lacey for the court answered and rejected arguments similar to all of those advanced by appellants here against the application of the doctrine of laches. We adopt for the purposes of the present case his reasoning in so doing without repeating it here, 728 F.2d at 1487-89. There we held that the laches defense could not be decided on the record before the court under circumstances peculiar to that case. Here the record of controlling circumstances is clear and indisputable.

We hold that appellants by their laches are barred from questioning the substantive or procedural validity of the

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butane and natural gasoline in violation of Subpart K," and that this encompasses the ethane exclusion rule. Again, it is somewhat remarkable that thus seeing in such a general claim the inclusion of the ethane exclusion rule, appellants have argued in another connection that they did not perceive in the rulemaking of Subpart K any advance notice of the inclusion of that rule, especially in view of the additional supporting signals given to them by the agency as already summarized.

ethane exclusion rule during the period it was in effect as a part of Subpart K.[31]

CONCLUSION

We have considered other related contentions and have found them to be without merit or unpersuasive.[32]

The judgment of the district court is affirmed in all respects except concerning the ethane exclusion rule. As to the latter, the judgment is reversed and that rule as incorporated in Subpart K is hereby adjudged to have been valid.

IT IS SO ORDERED.

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[31] *Cf.* Independent Bankers Ass'n of America v. Heimann, *supra*, where the district court failed to sustain the defense of laches and its judgment was reversed, and the case remanded with directions to dismiss the complaint.

[32] Appellants following oral argument lodged with the court a motion for leave to file a response, and an attached response, to a claimed misuse by defendants of extra-record material. This material is included as Appendix A in DOE's reply brief and consists of comments filed by Exxon in response to the proposed notice of rulemaking. DOE refers to the comments to support its argument that it was economically rational to allocate costs to ethane on a volumetrically proportionate basis. Appellants contend that DOE has misused the comments because they have nothing to do with volumetrically proportionate allocation to ethane of increased costs of shrinkage, DOE has extracted quotes out of context, and has ignored other statements that are directly contrary to the inference advanced by DOE. In our analysis, neither DOE's use (or misuse) of these comments, nor plaintiffs' response thereto, has had significance in the disposition of this appeal.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Civil Action No. CA-3-75-0836-W
(Consolidated)

DORCHESTER GAS PRODUCING COMPANY,
DORCHESTER GAS PROCESSING COMPANY,
EXXON CORPORATION, TEXACO INC.,
MOBIL OIL CORPORATION, and MOBIL OIL EXPLORATION &
PRODUCING SOUTHEAST INC.,
Plaintiffs,

v.

UNITED STATES DEPARTMENT OF ENERGY and
JAMES EDWARDS, Secretary of Energy,
Defendants.

MEMORANDUM OPINION

Each party to this consolidated action has filed its motion for summary judgment pursuant to Rule 56, F.R. Civ.P., and memorandum in opposition to the motion of the opposing party. Each party contends that the material facts are undisputed to support summary judgment in its favor and that material issues of fact exist which necessarily defeat the opposing motion. The court is of the opinion that the merits of this case can be resolved by summary judgment, that the material facts in the record before the court are undisputed in support of the judgment hereinafter ordered, and that only questions of law remain for resolution. This memorandum opinion shall constitute findings of fact from the undisputed evidence and conclusions of law.

BACKGROUND

The regulatory history behind promulgation of the pricing regulations at issue in this case has been heretofore discussed by the Temporary Emergency Court of Appeals (TECA). However, a short reiteration of that background may be helpful to an understanding of the controversy presented here.

In 1973, the Congress of the United States enacted the Emergency Petroleum Allocation Act (EPAA), 15 U.S.C. §§ 751, *et seq.* Under authority of the EPAA, the Federal Energy Administration (FEA), predecessor to the Department of Energy (DOE), enacted regulations concerning, *inter alia,* the pricing of natural gas liquids (NGL's) and natural gas liquid products (NGLP's). Subpart E, 10 C.F.R. §§ 212.81, *et seq.*, among the earliest of the regulations, was applicable to the extraction and pricing of NGL's by crude oil refiners. From the inception of the Subpart E regulations, however, the government placed gas processors within the broad category of "refiners" and considered the rules and procedures of that Subpart to be equally applicable to the gas processors. *National Helium Corp. v. FEA*, 569 F.2d 1137, 1145 (TECA 1977).

Soon after promulgation of the Subpart E regulations, it was recognized that the framework of price regulation for oil refiners was not well suited to gas processors. Accordingly, the FEA proposed and enacted a new Subpart K program of pricing regulations specifically applicable to the natural gas processors. The Subpart K rules became effective on January 1, 1975. These regulations, for the first time, attempted to specify the method for computing product costs of NGL's.

The plaintiff oil companies have challenged both the substantive and procedural validity of the regulations under Subparts E and K, as well as the DOE interpretation of various aspects of those regulations. These chal-

lenges will be discussed under separate headings although they are interrelated in many respects.

SUBPART K

The Subpart K regulations allowed the pass through, as an increased product cost, the "increased cost of natural gas shrinkage" to the price of NGL's. It is the computation of this cost of "shrinkage" which is at the heart of the controversy under Subpart K.

"Cost of shrinkage" is defined at 10 C.F.R. § 212.162 as:

> [t]he reduction in selling price per thousand cubic feet (MCF) of natural gas processed, which is attributable to the reduction in volume or BTU value of the natural gas resulting from the extraction of natural gas liquids, as determined pursuant to the contract in effect at the time for which cost of natural gas shrinkage is being measured, and under which the *processed* natural gas is sold. (emphasis added)

The DOE contends that this definition, when read in conjunction with the definition of "increased product costs," clearly reflects the agency's intent in promulgating the regulations that the increased product costs which could be passed through by the gas processor to the price of the extracted liquids was to be based upon the *weighted average* of all sales of the residue gas during the period of measurement. "Increased product costs" is defined at 10 C.F.R. § 212.167(b) as follows:

> (b) Increased product costs are . . .
>
> (3) the difference between the weighted average cost of natural gas shrinkage per thousand cubic feet (MCF) of natural gas processed in the month of May 1973, and the weighted average cost of natural gas shrinkage per thousand cubic feet (MCF)

> of natural gas processed in the current month, multiplied by the number of thousand cubic feet (MCF's) of natural gas processed in the current month.

Plaintiffs contend that the clear language of the regulations, and particularly the definition of "cost of shrinkage," permits them to pass through to the price of NGL's their "lost opportunity" cost, which is the price at which the shrinkage volume *could have* been sold had it not been used for extraction of the NGL's. In this regard, plaintiffs contend that fixed price contracts existing on the data of measurement are irrelevant to a determination of their lost opportunity costs or to a determination of the price at which the volume of natural gas could have been sold had it not been used to make up the NGL's. Plaintiffs further contend that the DOE interpretation, which would require consideration of existing fixed-price contracts in calculating "cost of shrinkage," would be contrary to the Congressional mandate expressed in the EPAA that price regulations allow a dollar-for-dollar pass through in net cost increases to covered products. *See* 15 U.S.C. § 753(b)(2)(A). Lastly, plaintiffs argue that the DOE interpretation would extinguish economic incentive for NGL extraction, thus violating the purpose of the EPAA and the regulations promulgated thereunder.

The requirement that deference be given to administrative interpretation of its own regulations when that interpretation is not plainly erroneous has been clearly enunciated by the United States Supreme Court in *Udall v. Tallman*, 380 U.S. 1, 16-17, 85 S.Ct. 792, 801, 13 L.Ed.2d 616 (1965):

> When faced with a problem of statutory construction, this Court shows great deference to the interpretation given statute by the officers or agency charged with its administraation. 'To sustain the Commission's application of this statutory term, we need not find that its construction is the only reason-

> able one, or even that it is the result we would have reached had the question arisen in the first instance in judicial proceedings.' (cites omitted) . . . *when the construction of an administrative regulation rather than a statute is in issue, deference is even more clearly in order.* (emphasis added)

It is the opinion of the court that DOE's interpretation requiring a weight-averaging of the sales of residue gas under all existing contracts during the current month, including existing long-term, fixed-price contracts, for purposes of determining cost pass throughs to NGL prices is neither plainly erroneous nor contrary to the regulatory language and should be given deference.

Under normal circumstances a gas processor processes a stream of wet natural gas through a plant, extracting the liquids therefrom. In the extraction process, the gas stream loses either volume or BTU content or both. Thus, the residue gas, or that gas which exists after processing, has a reduced selling price. For example, if 100,000 MCF's are measured into the gas plant and only 75,000 MCF's or equivalent BTU's remain after extraction, there is a shrinkage loss of 25,000 MCF's or equivalent BTU's. DOE contends that the cost of shrinkage is to be computed by weight-averaging the selling price of the 75,000 MCF's existing after extraction. Thus, if the 75,000 MCF's sell for $1.00 per MCF on a weighted average basis, for a total of $75,000, then the cost of shrinkage for the month in question would be $25,000. Plaintiffs contend that in determining whether or not to extract NGL's from a wet gas stream, they will consider the price they could receive for the wet stream if sold without liquid extraction. Thus, using the example above, if plaintiffs could sell 100,000 MCF's of unprocessed gas for $2.00 per MCF, or $200,000, while receiving only $75,000 for the residue gas after processing, then the option to extract would never be exercised. By letter dated June 20, 1983, after oral argument, counsel for plaintiffs also con-

tend that fixed price contracts under which the processed gas is sold is irrelevant in determining the weighted average and only the price for which the processed gas remaining after fulfilling the fixed price contract is sold is relevant in determining the permissible cost of shrinkage. Plaintiffs reason that there is no shrinkage in the amount of gas sold under the fixed price contracts as these contracts were fulfilled, hence no cost of shrinkage is incurred.

Plaintiffs' interpretation would permit only the use of the market or unregulated price for which the remaining gas could be sold. The definition of "cost of shrinkage," however, speaks in terms of the selling price of the *processed* natural gas,[1] which would necessarily include the *processed* gas sold under the fixed price contracts and which would necessarily exclude the price for which any *unprocessed* gas is sold or could have (lost opportunity) been sold. Consideration of the sales prices of gas on the unregulated market would defeat the intent of controlling NGL prices. The plain language of the regulation thus supports the DOE interpretation and accordingly, that interpretation is not plainly erroneous.

The court also rejects plaintiffs' argument that the agency's own interpretation of the shrinkage provisions of Subpart K supports opportunity costing and rejects the weighted-average method of pricing NGL's. Three of the "interpretations" upon which plaintiffs rely[2] are of little

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[1] *See* 10 C.F.R. § 212.162 ("[c]ost of shrinkage is the reduction in selling price . . . as determined pursuant to the contract in effect at the time for which cost of natural gas shrinkage is being measured and under which the *processed* natural gas is sold.")

[2] The "incremental costing letter" from Larry White, DOE's Regional Director of Compliance for Region VI to Texaco, the "Janoski Memorandum," and "Clarification 78-3" are all in the nature of informal advice by agency employees which do not have the statute of official agency interpretations through DOE's Office of General Counsel and accordingly, are to be accorded little weight for pur-

value and not controlling in that they do not constitute official agency interpretation of the regulations. The two formal interpretations issued by DOE's Office of General Counsel upon which plaintiffs rely do not support their theory that the shrinkage provisions allow for shrinkage calculations to be based on the market or "theoretical" value of natural gas. To the contrary, the Kansas-Nebraska Interpretation 1978-41, 43 Fed. Reg. 29548 (July 10, 1978), which involved primarily the issue of the effect of contract BTU adjustment clauses on calculation of the cost of shrinkage, contains strong language refuting the notion that the lost opportunity costs can be recouped on a dollar-for-dollar basis through the prices of NGL's.[3]

Plaintiffs allege that there has been an additional contemporaneous interpretation of the "cost of shrinkage" that supports their argument. Sun Oil Company Interpretation 1978-37, (43 Fed. Reg. 29543 (July 10, 1978)), does allow Sun Oil, under the very limited facts presented, to ignore and not consider certain transactions in the removal of NGL's from natural gas in calculating shrinkage costs. Under the facts considered in this particular interpretation, it appears that the gas subject to the long-

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poses of regulatory interpretation. *See Pennzoil Co. v. United States Department of Energy*, 680 F.2d 156, 171 (TECA 1982).

[3] ". . . While the opportunity costs described as increased shrinkage costs are the equivalent of increased product costs, such 'costs' do not represent outlays of dollars and therefore cannot literally be recouped on a dollar-for-dollar basis. Furthermore, the implicit extension of Kansas-Nebraska's position is that all opportunity costs associated with the production of covered products must be recovered on a dollar-for-dollar basis. Such general application of § 4(b)(2)(A) would arguably render unlawful any price limitations preventing the opportunity to sell covered products at a price reflecting the 'free market value' of the covered products in relation to unregulated products or activities theoretically available to the processor. Such a result would mean that the products generally must be priced at their current market value, a result incompatible with the very existence of price controls. . . ." 43 Fed. Reg. at 29550.

term contract with Sun Oil was owned by third parties and the title to this gas did not pass to Sun Oil, but Sun merely extracted the NGL's and returned the residue gas to the third party together with sufficient portion of its own gas to replace the loss of BTU's. DOE correctly held in this interpretation that there should be no consideration of the transactions between Sun and the third parties because it appears that there was not a "sale" from the third party to Sun or from Sun to the third party, but on the contrary, title to the third party's gas remained in the third party and only the title to the extracted NGL's passed to Sun. Under this fact situation there was no relevant sales price to be considered in determining a weighted average price. It should be emphasized that this interpretation was some three years after Subpart K became effective and was limited to the particular facts presented. Further, it was noted in the interpretation that under ordinary circumstances, "the sales of *all* residue gas which has been processed will be used to measure shrinkage cost." *Id.* Since there was not a sales of residue gas from Sun to the third party owner but merely a replacement by Sun of the loss of BTU's, this does not constitute an applicable contemporaneous agency interpretation of the language under Subpart K that would support plaintiffs' "opportunity cost" methodology under ordinary circumstances.[4]

It is the plaintiffs' position that if the court gives deference to the DOE interpretation of the Subpart K regulations, then those regulations should be found invalid in that they are arbitrary and capricious. In determining whether a regulation as promulgated is arbitrary and capricious, the court must determine whether in enacting

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[4] DOE in its reply brief, page 76, seems to concede that in this limited context, a gas processor would be permitted to exclude from shrinkage computation the natural gas processed under this exact factual situation as such a transaction would be "unrelated" to NGL extraction.

the regulation, the agency (1) made a clear error of judgment (2) considered the relevant factors, and (3) articulated a rational basis for the rule adopted.[5] *Bowman Transportation, Inc. v. Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 285 (1974). Plaintiffs contend that the pricing provisions under Subpart K, if given the DOE interpretation, lack any rational basis and were enacted based on a clear error of judgment in that the regulations, as so interpreted, conflict with the agency's stated purpose and ignore the economic realities of gas processing. Further, plaintiffs contend that in promulgating the regulations, DOE did not consider "factors of obvious relevance to the mechanistic application of a weighted-average residue sales price methodology," such as "the quantity limitation of fixed-quantity contracts" and "the presence of opportunity costs despite the absence of residue sales from cycling plants."

The court is of the opinion that the pricing regulations as promulgated under Subpart K, and as interpreted by the DOE, are not arbitrary and capricious. While a reviewing court may not supply a reasoned basis for agency action that the agency itself has not given, it "will uphold a decision of less than ideal clarity if the agency's path may reasonably be discerned." *Bowman, supra*, at 285-86.

The FEA, in the preamble to the Subpart K regulations, acknowledged that there was no single ideal solution to the regulation of natural gas liquid prices and stated that the regulations as promulgated were a necessary compromise among the conflicting considerations which existed. ". . . [T]he fundamental objective is to

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[5] TECA, in analyzing whether the agency has "articulated a rational basis for the rule adopted," has been primarily concerned with whether the enacted regulation has a rational basis or demonstrates a rational connection with the stated policies and objectives of the regulations. *See*, e.g., *Mobil Oil Corporation v. DOE*, 610 F.2d 796, 801 (TECA 1979).

permit prices that will be as low as reasonably possible without adversely affecting the availability of the product." 39 Fed. Reg. 44408 (December 24, 1974). In this regard, the agency explained that it was adopting a "cost-based" system with respect to the pricing of natural gas liquids which continued in effect the reference point of May 15, 1973, from which increased costs and lawful prices were to be determined, with a provision for the addition of an increment to the May 15, 1973 selling prices to account for the "actual increased cost of natural gas shrinkage attributable to the production of natural gas liquids since that date." *Id.* In explaining the reference to the May 1973 pricing of NGL's, the agency noted that "[t]his method of price determination serves, in general, to preserve a seller's May 15, 1973 margin (i.e., the difference between May 15, 1973 product costs and May 15, 1973 selling prices) and to provide for a dollar-for-dollar pass through of increased product costs." *Id.*

Plaintiffs now contend that because they are precluded under the DOE interpretation of the regulations from increasing their profit margin from what it was in May 1973, they are precluded from passing through, on a dollar-for-dollar basis, their increased *costs* of extraction. DOE recognized that its cost-based system of regulation would limit the profit margin to be received by gas processors from the NGL's, yet, as explained in the preamble, chose this structure in an effort to keep prices as low as possible without adversely affecting supply. Plaintiffs maintain that the cost-based system, as interpreted by DOE, creates disincentive, contrary to Congressional mandate, in that no refiner or processor who can receive a greater profit by selling natural gas in its raw state would ever opt to extract NGL's. It was an agency judgment, however, that if the profit margin received from sale of NGL's in May 1973, at a time when the market was unregulated, was sufficient incentive at that time for NGL extraction, that same profit margin would or should spark incentive during the period of regulation. Whether

or not that assumption was totally realistic, this court cannot find on the basis of the record that the regulation lacks a rational basis or that the agency made a clear error in judgment in light of its duty to regulate the prices of NGL's. Price control, to some degree, will always disregard or distort economic reality and the record does not reflect that undue distortion resulted or would have resulted had there been a clearer understanding in the industry of the agency's intention regarding cost pass-through.

The court further finds that the agency, in enacting the pricing provisions in question, did not fail to consider the relevant factors. Congress required in § 4(b)(2)(A) of the EPAA, 15 U.S.C. § 753(b)(1), that the President, in enacting pricing regulations to deal with the existing shortages of crude oil and refined petroleum products, provide *to the maximum extent possible* for

> (D) preservation of an economically sound and competitive petroleum industry; including the priority need to restore and foster competition in the producing, refining, distribution, marketing, and petrochemical sectors of such industry, and to preserve the competitive viability of independent refiners, small refiners, nonbranded independent marketers and branded independent marketers.
>
> * * * *
>
> (H) economic efficiency, and
>
> (I) minimization of economic distortion, inflexibility, and unnecessary interference with market mechanisms.

Additionally, the agency was required by Congress to formulate price regulations which would allow a "dollar-for-dollar pass through in net cost increases" to the regulated products. 15 U.S.C. § 753(b)(2)(A).

"By requiring the attainment of the specified objectives 'to the maximum extent *practicable*,' Congress recog-

nized that the objectives were to a certain extent inconsistent and intended that the FEA would exercise its discretion in achieving a workable balance among them." *Amtel, Inc. v. Federal Energy Administration*, 536 F.2d 1378, 1383 (TECA 1976). *See* also House Report No. 93-531, 93rd Cong., 1st Sess. (1973), *reprinted in* U.S. Code Cong. & Ad. News, 2582, 2594 (1973). ("The list of objections set forth in subsection (b) is *not* a schedule of priorities. The President is directed to accomplish all of these objectives to the maximum extent that may be practicable" (emphasis supplied).

In addition to the EPAA requirements, DOE was also faced with two conflicting objectives in formulating price regulations for NGL's: 1) the need to foster industry incentive for NGL extraction; and 2) the need to keep prices as low as possible for the NGL consumers. Subpart K Preamble, *supra*.

The administrative record reflects that due consideration was given to the issue of whether the necessary objectives could best be served by placing a ceiling on the price of NGL's as opposed to permitting a flexible price based on the varying costs of natural gas and crude oil.[6] Similar consideration was given to the issue of whether the proposed regulations reflected appropriate profit margins to stimulate NGL extraction.[7] Specific discussion

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[6] *See*: Statement of P. E. Goth, Jr., Marketing Manager for Liquified Petroleum Gas, Phillips Petroleum Co. (opposing a price ceiling); Statement of Jones Landry, General Counsel, Air Transport Association of America (ceiling price necessary); Statement of Ben Vaughn, III, Normanne Gas Processing Plant (fixed price ceiling helpful).

[7] *See*: Statement of Victor Cino, President, Association of Shell Dealers, Inc. (proposed profit margin inflationary); Statement of John Orr, Executive Secretary, Oklahoma LP-Gas Association (proposed profit margin acceptable), Statement of Don Weems, Executive Secretary, Missouri LP-Gas Association (proposed profit margin acceptable); Statement of Terrence Redmond, Vice President, Planning and Administration, Amoco Oil Co. (limitation on profit

was given to the proposed provisions on shrinkage, though it is interesting to note that calculation of shrinkage cost per se did not appear to be of great concern to the industry at the time of the public hearings on promulgation of proposed regulations.[8]

The court concludes, after thorough examination of the administrative record, that the agency gave consideration to factors relevant to accomplishing, to the maximum extent practicable, the objectives and duties imposed upon it by Congress.

DOE's contention that the challenges to the pricing provisions under Subpart K are barred by laches is rejected. The original complaint which gave rise to this lawsuit was filed in 1975, only months after promulgation of Subpart K. That complaint substantively raised the issues on which declaratory judgment is now sought. Thus, the court finds that issues involved here were presented in a timely fashion and that their resolution should not be precluded on that basis.

SUBPART E

Pursuant to the initial "Phase IV" price regulations, the Cost of Living Council promulgated Subpart E, 10 C.F.R. §§ 212.81 *et seq.*, in 1973. Subpart E remained in effect through the calendar year 1974 and governed prices charged by refiners for their produced NGL's. The regulations, which referred specifically to refiners, were construed to apply to the sale of NGL's by natural gas processors. *National Helium Corporation v. FEA*, 569

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margin should be eliminated); Statement of J. W. Kinnear, Texaco Inc. (proposal to restrict profit margin unacceptable).

[8] In responding to a question of whether the proposed regulations permitting NGL prices to reflect shrinkage costs would improve the competitive situation of small independent gas processors, Mr. Richard L. Cook, President of McCulloch Gas Processing Corp., stated, "No. It is not that big of a deal. It is a very small part of the recovery costs, very minor. . . ."

F.2d 1137, 1145 (TECA 1977). These regulations specifically recognized transfer prices between "affiliated companies" for the purpose of calculating a refiner's increased costs. *Gulf Oil Corporation v. DOE*, 671 F.2d 485, 487 (TECA 1982).

During the Subpart E period, plaintiffs calculated "increased product costs" for its internally produced NGL's by assigning a transfer price to the raw natural gas from which liquids were extracted based on current market value of the gas. This transfer price was then compared to the intrafirm transfer price for natural gas during the month of May 1973 which was derived on the same basis, with any increase passed through as an increased cost of NGL production.

Plaintiffs contend that intrafirm transfer prices were derived through use of the firm's historic accounting procedures and that the regulations specifically allowed use of historic or customary accounting procedures in calculating increased product costs. DOE contends that use of customary accounting procedures was allowed under the regulations only in computing costs of foreign or imported crude, 10 C.F.R. § 212.83(b), and that the phrase had no applicability to domestically produced NGL's. Further, DOE contends that the Subpart E regulations specifically contemplated that only *actual* increased product costs could be passed through to the price of NGL's and that the intrafirm transfer prices assigned by plaintiffs to natural gas did not reflect actual cost increases.

The issue for the court is whether plaintiffs' pricing of internally produced NGL's during the Subpart E period was reasonable in light of the regulatory language and purpose. The court finds that it was not.

It is clear that Subpart E was intended to apply to transfers between affiliated entities under certain circumstances specified therein. Specifically, in calculating "increased product costs," 10 C.F.R. § 212.83(b), refiners

were required to compute the difference in the cost of crude petroleum during the month of measurement and compare it to the cost of crude petroleum during May 1973. In calculating this cost of crude, the regulation further required that for transactions between affiliated entities involving new domestic crude, the cost which was to be imputed was the "posted" price. For transactions between affiliated entities involving imported crude, the regulations permitted use of customary accounting procedures for computation of costs of crude petroleum which could ultimately be used in computation of increased product costs. This use of customary accounting procedures was subject, however, to the right of the Federal Energy Office (FEO) to allocate costs between affiliated entities if, in its judgment, such allocation was necessary to reflect *actual costs* to the affiliated entities. *See* 10 C.F.R. § 212.83(e). Thus, while the regulations permitted use of customary accounting procedures in deriving a price for foreign crude oil purchased in transactions between affiliated entities, the agency expressed its concern that such price be reflective of actual costs to the affiliated entities involved. The court agrees with DOE that to the extent plaintiffs were assigning prices on intrafirm transfers of NGL's based upon factors other than actual increases in costs of NGL production, the practice was unreasonable and contrary to the regulations.

This finding is supported by the preamble to the Emergency Amendment to the Special Propane Rule, 39 Fed. Reg. 28608 (August 9, 1974), wherein the agency clarified that "[i]n the case of domestic natural gas liquids and propane, it is clear that no increased costs should be attributed to transactions with affiliated entities, and this has therefore been made explicit in the new rule." Plaintiffs contend that this amendment pertained only to propane and that the preamble therefore provided no guidance whatever for NGL pricing in general. Further, plaintiffs contend that the emergency amendment to

the propane rule was procedurally invalid and thus of no force and effect. While the propane amendment dealt specifically with computing a base price for propane, the preamble thereto served to place the industry on notice of the agency view of the effect of affiliate transfers on pricing of domestic NGL's under Subpart E. Further, the agency finding and explanation that promulgation of the amendment was necessary without opportunity for notice and comment inasmuch as "announcement of the rule as a proposal would involve substantial likelihood that supply patterns would be disrupted in anticipation of the adoption of the proposal," and that "[s]uch disruption would be particularly injurious to the public welfare in view of the need for propane . . . as the harvesting and heating seasons approach . . . ," satisfied the requirements for waiver of notice set forth at 15 U.S.C. § 766(i)(1)(B). The facts in the record are undisputed that it was the critical need for natural gas liquids, particularly propane and butane, which gave rise to the NGL pricing regulations in the first instance.

The court further finds that during the Subpart E period there was no official agency interpretation to support plaintiffs' pricing method for internally produced NGL's.[9]

Plaintiffs contend that if the court finds that they were not permitted to use their "historical accounting methods" in calculating the increased costs of NGL's prior to January 1, 1975, they are entitled to calculate the cost of NGL's based upon the increase in the value of natural gas shrinkage. The court agrees that on May 27, 1975, the FEA announced in its Ruling 1975-6, 40 Fed. Reg. 23272 (1975), that the shrinkage cost provisions of

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[9] Plaintiffs' argument that the agency's contemporaneous construction of Subpart E is supportive of their pricing method for internally produced NGL's is based upon informal agency advice which this court cannot consider as controlling official agency interpretation of its regulations. *See Pennzoil, supra.*

Subpart K were to be applied retroactively to NGL pricing during the Subpart E period. Accordingly, the court finds that during the Subpart E period, plaintiffs were entitled to calculate costs of NGL's pursuant to the shrinkage provisions of Subpart K as construed herein.

Finally, DOE's argument that Texaco Inc. has no standing to urge acceptance by the court of the opportunity cost pricing method for NGL's during the Subpart E period is rejected. In *United States of America v. Texaco, Inc.*, Civil Action No. CA-79-0031, the DOE filed complaint against Texaco asserting violations by Texaco of Subpart E for using the opportunity costing method of pricing NGL's. Thus, DOE's argument that Texaco never utilized such a method during the Subpart E period cannot be entertained, and under the circumstances, Texaco has standing to assert that argument.

VOLUME—PROCESSED FORMULA

10 C.F.R. § 212.167(b) provides for the "volume of gas processed" method of calculating shrinkage costs. In specifying the "increased product costs" which could be passed through to the price of NGL's, the regulations required comparison of:

> . . . the difference between the weighted average cost of natural gas shrinkage *per thousand cubic feet (MCF) of natural gas processed* in the month of May 1973, and the weighted average cost of natural gas shrinkage *per thousand cubic feet (MCF) of natural gas processed* in the current month, multiplied by the number of thousand cubic feet (MCF's) of natural gas processed in the current month. 10 C.F.R. § 212.167(b) (emphasis added).

Plaintiffs challenge both the substantive and procedural validity of this "volume of gas processed" formula, hereafter referred to as "volume-processed" formula.

a. *Procedural Issue*

At the time of the adoption of Subpart K, the FEA was required to follow the procedural requirements for rule-making set forth in the Administrative Procedure Act (APA) and in the Federal Energy Administration Act. *Standard Oil Co. v. DOE*, 596 F.2d 1029 (TECA 1978). Plaintiffs contend that the DOE failed to observe the APA provisions which require the agency to give notice of the terms or substance of the proposed rule or a description of the subjects and issues involved. 5 U.S.C. § 553(b). Plaintiffs also contend that the agency disregarded the FEAA requirement that notice of any proposed rule or regulation be given by publication in the Federal Register and that a minimum of ten days following such publication be provided for opportunity to comment. 15 U.S.C. § 766(i)(1)(B). In this regard, plaintiffs contend that final version of the volume-processed formula was so far afield from the proposed regulation that, in addition to the lack of notice, the FEAA requirement of publication of the regulation was violated. Finally, plaintiffs challenge the procedural validity of the formula on grounds that the agency failed to publish with the final regulation a statement of basis and purpose of the selected rule as required under § 553(c) of the APA. The court finds that all of the procedural challenges discussed above are without merit.

The formula, as it appeared in the Subpart K proposal, read as follows:

> Increased product cost with respect to a gas plant is . . . (b) the difference between the weighted average cost of natural gas shrinkage in the month of May 1972 [sic] and the weighted average cost of natural gas shrinkage in the month of measurement, multiplied by the volume of natural gas processed in the month of measurement, where:
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> "Cost of natural gas shrinkage" means the reduction in sales price of natural gas, *per unit of volume*

> *or BTU content, of natural gas processed* in a gas plant which is attributable to *reduction in volume or BTU content* by the removal of liquids in the gas plant. 39 Fed. Reg. 32730. (September 10, 1974)

It is the opinion of the court that the regulation as proposed in the Federal Register (and particularly the proposed definition of "cost of shrinkage") provided fair notice that the agency contemplated calculating increased product costs for NGL's on the basis of *volume* of gas processed rather than on the basis of shrinkage volume alone. Further, the court is of the opinion that the formula, as finally promulgated, did not alter the implicit requirement that the regulations allow for a dollar-for-dollar pass through of increased costs and accordingly did not require reiteration of its basis and purpose.

b. *Substantive Issue*

Plaintiffs contend that notwithstanding any procedural defects in the enactment of the volume-processed formula, the regulation must be stricken as arbitrary and capricious under the three-pronged *Bowman* test. The thrust of plaintiffs' argument in this regard is that because the formula does not consistently allow for a dollar-for-dollar pass through of costs to the price of NGL's, it must be stricken as having been enacted pursuant to a clear error in judgment, with no rational basis, and without consideration of the relevant factors.[10] As indicated above, the court is of the opinion that the formula as enacted does not negate the Congressional mandate that increased costs be recovered on a dollar-for-dollar basis.

Plaintiffs contend that by making increased costs a function of the volume of gas processed rather than of

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[10] Plaintiffs support their argument that the formula does not allow dollar-for-dollar pass through by using two examples attached hereto, and the position of DOE is as illustrated by the affidavit of Neely W. Tipton, all of which are attached hereto as appendices.

the shrinkage volume, irrelevant factors are considered and actual costs are not reflected. That is, according to plaintiffs, the formula considers the volume of gas *not* converted into NGL's in addition to the volume which is converted to arrive at the shrinkage cost. This, plaintiffs contend, allows two gas processors who have the same shrinkage volume and the same residue gas prices in the current month to have different shrinkage costs. DOE does not dispute that the formula can yield such a result, but contends that such a result is reasonable since in that example, the two gas processors processed different volumes of gas to arrive at the same volume of shrinkage. Thus, according to DOE, the formula operates to reward the more efficient processor who increases his extraction rate over that of another processor from the same volume of gas.

DOE further contends that the formula automatically operates to leave both gas processors with the same *net* improvement in revenue for the combined sale of residue gas and NGL's.

That is, according to DOE, there is a direct correlation betewen NGL's extracted and the volume of residue gas remaining after extraction in that lesser shrinkage from a given stream of natural gas (whether due to gas plant inefficiency or a decline in the stream's liquid content) yields a greater volume or BTU content in the residue gas which can in turn be sold by the processor.

The court agrees that the formula as enacted served to equalize the net revenues received by two gas processors with different extraction rates.[11] Thus, the formula can-

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[11] Plaintiffs' theory would allow a processor with a lesser extraction rate to pass through to the price of NGL's the same costs as the processor with the greater extraction rate and at the same time permit the former processor to receive a greater price on the sale of its residue gas since either the volume or BTU content of that residue would be greater given the lesser liquid extraction. Such

not be said to have created disincentive in the industry for NGL extraction. Further, the formula served to keep NGL prices low for the consumer. Accordingly, the court finds that the formula had a rational connection with the stated purpose of the regulations and was not based upon a clear error of judgment.

Furthermore, the court finds that the formula did not ignore the dollar-for-dollar pass through requirement of the EPAA. Since the formula permits two processors who consume different volumes of natural gas in producing the same quantity of NGL's to recover the same revenue or profit upon sale of the combination of processed NGL's and residue gas, there is no preclusion in recovery of costs. Since the formula is not contrary to the Congressional mandate and furthers the regulatory objectives, the court cannot find that the agency failed to consider relevant factors prior to its adoption. Accordingly, the court cannot find the volume-processed formula to be arbitrary and capricious.

THE ETHANE EXCLUSION

Plaintiffs challenge both the substantive and procedural validity of the ethane exclusion under Subpart K. Ethane was one of the NGL's which was not among the products subject to price control under the EPAA. 15 U.S.C. § 752(5) and (6). Subpart K, however, attempted to exclude from the cost of shrinkage any increased product cost attributable to ethane. 10 C.F.R. § 212.168(a).[12]

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a theory is not only inequitable when considered from the standpoint of the processor who achieves a greater rate of extraction but is unreasonable in light of the regulatory objectives.

[12] 10 C.F.R. § 212.168(a) provides in relevant part:

(a) Exclusion of increased product costs attributable to ethane. The total amount of increased product costs attributable each month to a given volume of natural gas shall be reduced each month by an amount equal to the product of the increased product costs multiplied by (Ve^u/V^u). Where:

The relevant formula required, in essence, that the total increased product cost be reduced by an amount of increased product cost attributable to ethane. Thus, if 10% of the volume of NGL's processed was ethane, then the amount of increased product cost resulting from shrinkage would be reduced by that percentage.

Plaintiffs challenge the ethane exclusion provision, contending that the formula arbitrarily and capriciously allocates an excessive portion of shrinkage costs to ethane.[13] The procedural validity of the rule is challenged on the basis that DOE allegedly gave no notice that it planned to include an ethane allocation provision in Subpart K which precluded opportunity for industry comment. The procedural challenges will be addressed first.

Plaintiffs contend that the ethane allocation provision appeared for the first time in the final version of Subpart K and state that it was a completely novel provision. DOE challenges the assertion that the provision was new, contending that it was the same formula, known as the "V Factor," which was a part of the old Cost of Living Council (CLC) regulations and which was recodified under Subpart E.

On April 30, 1974, the V Factor, as it appeared under Subpart E, was amended.[14] Shortly after the April 30

V^u = the total volume of natural gas liquid products and ethane derived from that volume of natural gas and sold in the current month and

Ve^u = the total volume of all ethane derived from that volume of natural gas and sold in the current month.

[13] The record indicates that ethane has only slightly more than fifty percent of the BTU content per MCF than other NGL's.

[14] The amendment provided that costs attributable to a particular product would be calculated on the basis of the following formula:

$$\frac{\text{VOLUME OF PARTICULAR PRODUCT SOLD}}{\text{VOLUME OF ALL COVERED AND NON-COVERED PRODUCTS SOLD.}}$$

10 C.F.R. § 212.83(c)(2).

amendment, on September 10, 1974, the Subpart K proposal was issued. According to DOE, the Subpart K rules were to be an adjunct to Subpart E for the purpose of NGL costing and thus, the Subpart E rules were to apply to gas processing and sale of NGL's except to the extent that they were modified or superseded by Subpart K. In this regard, proposed § 212.144, "Application of Increased Costs," read in pertinent part:

> Any firm which incurs increased product costs or increased non-product cost with respect to processing or fractioning natural gas liquids in a particular plant may pass such costs through, *in accordance with the cost pass through provisions for increased costs of Subpart E.* 39 Fed. Reg. 32730 (September 10, 1974) (emphasis added).

DOE contends that this provision placed the industry on notice that the agency would continue all existing rules under Subpart E, including the V Factor which required volumetric allocation of increased product costs to ethane and other exempt products. After the agency's decision to make Subpart K a separate set of regulations applicable solely to gas processors, the V Factor, as it related to ethane (the only exempt product for natural gas processing) was "transferred" to Subpart K. According to DOE, the transfer was merely a "technical amendment" which did not impose a substantive change in the duties and obligations of the regulated parties, and thus, did not require prior notice and opportunity for comment.

In 1978, the Temporary Emergency Court of Appeals (TECA) declared the V Factor, as it existed under Subpart E, to be both substantively and procedurally invalid. *Mobil Oil Corp. v. DOE*, 610 F.2d 796 (TECA 1979). In *Mobil*, TECA held that the April 30, 1974 amendment to the V Factor from which the Subpart K ethane exclusion was taken, was null and void as having been promulgated in violation of the notice and comment provision of the APA. *Id.* at 804. The court also found that DOE's action

in promulgating the amendment to be arbitrary and capricious in that the agency failed to consider the relevant factors or objectives set forth in the EPAA. *Id.* at 801-802.

Although DOE may be correct in its position that at the time the ethane exclusion was promulgated, it considered that its action was only a "technical transfer" which required no further notice and opportunity for comment, the "transfer" was of a provision which has been conclusively determined to have been null and void, procedurally and substantively. It would be unreasonable to find that the transfer to a new subsection gave the provision new life. The ethane exclusion provision has, in effect, been determined by a final decision of TECA to be invalid, and this court cannot find to the contrary.

DOE's contention that the doctrine of laches prevents any judgment on behalf of the plaintiffs on the ethane exclusion is rejected. Laches is not available as a defense where, as here, the regulation in question has been ruled null and void.

LEASE METER ISSUE

Subpart K, on its face, is silent on the issue of whether the volume of gas to be processed into NGL's was to be measured by utilizing meters located in the field near the producing wells or by meters located at the processing plant. DOE contends that the definition of shrinkage itself and the agency's early interpretations require that the reduction in the volume of gas due to extraction of the liquids be measured within the confines of the gas plant where the extraction process occurs. Plaintiffs, Exxon and Texaco, always measured the volume of gas processed by the plant meters and accordingly have no argument with DOE on this issue. Mobil, however, measured the wet stream prior to NGL extraction through its lease meters located in the field, which Mobil contends were its most accurate meters and the meters

it used for accounting purposes. Measurement by use of field meters was reasonable and justified, according to Mobil, in view of regulatory silence on the issue. Further, Mobil contends that its practice furthered the purpose of Subpart K in that it provided a full dollar-for-dollar compensation of costs of NGL extraction.

The court agrees with the DOE that measurement of the volume of gas processed from the field meters is not a reasonable interpretation of the Subpart K shrinkage provisions. While plaintiffs may be correct that the inception of the extraction process is when the processor takes possession of the natural gas in the field, the purpose of the shrinkage provisions, as clearly stated in the preamble, was to compensate the processor for reduction in sales revenues received from the natural gas because of the reduced gas volume or BTU content of the gas *after processing*. 39 Fed. Reg. 44409 (Dec. 24, 1974). That is, the purpose of the shrinkage provisions was to compensate for volume reduction resulting from extraction, not for line loss which occurred from the lease to the plant.

Additionally, Mobil cannot seriously contend that it remained totally in the dark after Ruling 1975-18, 40 Fed. Reg. 55860 (December 2, 1975) as to which meters it could properly utilize to measure its volume processed. Early in that ruling, the agency clarifies that "[t]o qualify as an increased product cost, any shrinkage cost must be *related to the extraction process*, which the FEA defines to include *only the extraction of natural gas liquids from the 'wet' gas stream.*" 40 Fed. Reg. at 55861. (emphasis added). That "cost of shrinkage" was to be limited to those costs closely related to the *extraction* of natural gas liquids was again emphasized in the agency's discussion of treatment of condensate:

> . . . [a]ny reduction in the value of 'wet' natural gas which results from the separating out of condensate lacks the requisite connection with the extraction of natural gas liquids, even though both

> processes may be performed at the same processing facility by the same party.
> *Id.* at 55862.

Finally, discussion in the ruling of "inlet" meters has reference to those meters located at the plant facility. This, too, is clarified in the agency's discussion of the treatment of condensate for purposes of shrinkage:

> In yet other cases, condensate is not separated from natural gas until it reaches a mechanical separation device *similar to a* surface separation or *field facility, but located instead at the inlet side of a gas processing plant* . . . and, in that case, the condensate is referred to as 'plant condensate.'
> *Id.* at 55861.

Thus, the court cannot find that the agency's statement in September 1978, in the preamble to the Subpart K amendments, that the " 'inlet' of a gas plant remains the inlet to the extraction plant proper . . .," constituted a retroactive interpretation of the regulations or that the statement fundamentally altered Subpart K in violation of § 553 of the APA. The court concludes that Mobil's measurement practices were inconsistent with the clear language of Subpart K and constituted an unreasonable construction of the shrinkage provisions.

THE DORCHESTER CLAIM

Dorchester Gas Producing Company and Dorchester Gas Processing Company (Dorchester) instituted this action seeking declaratory judgment that Subparts E and K are unlawful and void, particularly as applied to independent gas processors. The Dorchester action was consolidated in this case with similar actions instituted by other named plaintiffs. Dorchester has largely adopted the position taken by the other plaintiffs, discussed above, and the rulings stated above on the various issues discussed are equally applicable to the plaintiff Dorchester.

In its brief, however, Dorchester has made certain arguments which it contends are unique to its own situation.

Dorchester, a natural gas processor, contends that the language of Subpart E addresses itself *only* to crude oil refiners and that those regulations, when applied to natural gas processors, are confusing and ambiguous. The applicability of Subpart E to gas processors, Dorchester contends, is an unresolved issue. Further, Dorchester argues that the regulations under Subparts E and K which tie shrinkage costs to contract prices for sales of the residue gas is discriminatory to Dorchester and other gas processors similarly situated in that a great majority of the natural gas processed by those companies was sold in interstate commerce and thus regulated by price ceilings set forth by the Federal Power Commission (FPC). The FPC price ceilings, according to Dorchester, "are established in a manner totally unrelated to replacement costs." (Page 11, Dorchester's reply brief in opposition to defendants' motion for summary judgment.) Finally, Dorchester contends that the retroactive application of Subpart K, as announced in Ruling 1975-6, *supra*, does little to alleviate the hardship which the Subpart E regulations imposed on processors in Dorchester's position. In this regard, Dorchester claims that the ruling, allowing natural gas processors to use the Subpart K shrinkage provisions for recovery of increased product costs for the pre-1975 period (by permitting the pre-1975 increased costs to be added to the processors' "banks" for future pass throughs) was of no benefit to those such as Dorchester which had sold or disposed of its processed NGL's prior to May 1975.

TECA, in *National Helium Corporation v. FEA*, *supra*, has conclusively ruled that the Subpart E regulations, although written with the crude oil refiner in mind, were equally applicable to natural gas processors. In that opinion, TECA noted that although the Subpart E regulations were not well suited to achieve a particular goal, this did

not "necessarily mean that the parties subject to those rules may avoid their application by claiming they were not on notice, especially where, as here, the agency continuously asserted that the parties were subject to the agency's authority." 569 F.2d at 1144. Without deciding whether Dorchester properly interprets Ruling 1975-6, this court is bound by *National Helium* and cannot find the Subpart E regulations null and void or inapplicable to Dorchester. Further, the court finds that the challenge to Subpart K on the grounds of its discriminatory effect on Dorchester, without more, is insufficient to justify a finding that the regulatory scheme is arbitrary and capricious. This court will not reject an administrative decision "merely because one producer's piece of cake is iced and another's is not." *Placid Oil Company v. Federal Power Commission*, 483 F.2d 880, 905 (5th Cir. 1973), *affirmed sub nom. Mobil Oil Corp. v. FPC*, 417 U.S. 283 (1974).

Accordingly, with regard to the Subpart E issue, the shrinkage provisions under Subpart K, the volume-processed formula issue and the lease meter issue, the court hereby grants defendant-DOE's motion for summary judgment and denies plaintiffs' corresponding motion thereon. The court further grants DOE's motion for summary judgment with regard to the Dorchester issues. With regard to the ethane exclusion issue, the court hereby grants plaintiffs' motion for summary judgment and denies DOE's corresponding motion thereon.

The attorneys will confer and submit to the court a judgment in accordance with this order.

The Clerk will furnish a copy hereof to each attorney.

ENTERED this 24th day of June, 1983.

/s/ Halbert O. Woodward
HALBERT O. WOODWARD
Chief Judge
Northern District of Texas

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Civil Action No. CA-3-75-0836-W
(Consolidated)

DORCHESTER GAS PRODUCING COMPANY,
DORCHESTER GAS PROCESSING COMPANY,
EXXON CORPORATION, TEXACO INC.,
MOBIL OIL CORPORATION, and MOBIL OIL EXPLORATION &
PRODUCING SOUTHEAST, INC.,
Plaintiffs,

v.

UNITED STATES DEPARTMENT OF ENERGY and
DONALD HODEL, Secretary of Energy,
Defendants.

MEMORANDUM ORDER

Judgment has not been entered in this case but a memorandum opinion was filed on June 24, 1983. Various motions have since been filed by the defendants. The court's opinion of June 24th is referred to and adopted as a part of this memorandum order except to the extent that it may be modified or changed herein. All outstanding motions will be disposed of by this memorandum order.

Briefly, the plaintiffs in this case seek a declaratory judgment which would in effect nullify certain regulations and interpretations of the defendant and its predecessor agencies and the defendants pray for a declaratory judgment upholding these same regulations and interpretations.

BACKGROUND

Under the authority of the Emergency Petroleum Allocation Act (EPAA) 15 U.S.C. §§ 751 *et seq.*, the FEA promulgated Subpart E which controlled the price refiners could charge for certain petroleum products, including NGLs. Natural gas processors were held to be "refiners" and thus subject to Subpart E. *National Helium Corp. v. FEA*, 569 F.2d 1137, 1145 (TECA 1977). The Subpart E regulations, however, were better suited for crude oil refiners, and in 1974 the FEA proposed Subpart K regulations specifically applicable to natural gas processors. Subpart K became effective January 1, 1975.

Both parties (by cross motions for summary judgment) seek to have their methods for calculating the increased costs of natural gas from which NGLs are extracted declared reasonable and the methods of the opposing party declared unreasonable.

In its previous memorandum, the court essentially held that the regulations and interpretations of the Department of Energy (DOE) were proper and, with the exception of the ethane exclusion, the court denied plaintiffs' motion for summary judgment and granted the cross motion for summary judgment filed by the defendant. The various motions subsequently filed by plaintiffs generally assert the following:

(1) Though the court held the transfer-pricing method unreasonable under Subpart E, given the ambiguity of the regulation, plaintiffs' alternative "incremental" method should be held reasonable.

(2) Under the recent Supreme Court decision the promulgation of Subpart K was arbitrary and capricious since DOE failed to consider fixed-quantity contracts.

(3) The court misread or overlooked various agency interpretations.

(4) The inclusion of the fixed-quantity contract price in the weighted average cost of shrinkage is an unreasonable interpretation of Subpart K in that there was no revenue loss attributable to the fixed-quantity contracts.

(5) The underlying Acts, the EPAA and EPCA, are invalid (under the *Chadha* decision) because they both contain one-house veto provisions.

Because this case covers two distinct regulatory periods, it is necessary to briefly outline the methods actually used by the plaintiffs during the relevant periods. Subpart E was in effect from late 1973 through 1974 and Subpart K became effective January 1, 1975.

TEXACO

During Subpart E period and until 1976, Texaco used a transfer pricing method of calculating increased costs. During 1976 and early 1977, Texaco used the weighted average method of calculating cost of shrinkage now advocated by DOE. During this latest period, Texaco computed the weighted average by using the sales price for *all contracts* from the sale of gas from its processing plant, including fixed-quantity contracts and contracts for the sale of surplus gas.[1] In May 1977, *Texaco* began using its so-called "incremental method"; that is, Texaco calculated shrinkage costs based on suplus contract prices, excluding from the calculation the price received under the fixed-quantity contracts. Affidavit of B. B. Fox in Support of Texaco Inc.'s Motion for New Trial, page 2. In December 1978, Texaco refiled to claim increased costs for the period prior to May 1977 to reflect costs computed pursuant to the incremental method.[2] Counsel for Texaco

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[1] Argument of counsel for Texaco at the October 25, 1983 hearing in Abilene, Texas.

[2] Counsel for Texaco and the letter from Texaco's Comptroller to Mr. Richard Anderfuren state that Texaco refiled in December 1978. The Affidavit of B. B. Fox, however, states that Texaco refiled in October 1979.

at the October 25, 1983 hearing stated that the re-filings were "accepted by DOE."

EXXON

Plaintiff Exxon passed through no increased costs for NGLs during August, September, and October 1973. During the period November 1973 through March 1974, Exxon computed increased costs under a formula permitted for old crude oil. *See* Exxon's Supplemental Answers to Defendant's First Set of Consolidated Interrogatories and Request for Production of Documents filed April 1, 1982. In April 1974, Exxon again changed methods and until December 1974, utilized a transfer pricing method, based on its historical system of accounting. This formula utilized the Exxon posted prices for propane and motor gasoline. Exxon re-filed, seeking to make this transfer pricing method effective as of November 1973. *Id.* During Subpart K, Exxon employed its incremental method of calculating shrinkage.

MOBIL

Plaintiff Mobil initially challenged the regulatory control of NGLs under Subpart E, lost this suit, and then refiled and used what is in effect the incremental method. *Mobil Oil Corp. v. F.E.A.*, 566 F.2d 87 (TECA 1977). The court in *Mobil* affirmed the holding of the district court that the FEA has authority "to regulate the regulating and pricing of all liquid petroleum products recovered from the 'wet' natural gas streams, including condenstate, natural gas liquids and natural gas liquid products recovered at gas processing plants (propane, butane, and natural gasoline except ethane)." 566 F.2d 87 (TECA 1977). Mobil, during both the Subparts E and K periods, sold processed gas under five fixed volume contracts and sold the remainder under a sixth contract to Channel Industries. The parties disagree over the characterization of the Channel Industries contract as a "sur-

plus" contract. The Channel contract did in fact contain a maximum volume limit term, but that limit was exceeded only once. In calculating its increased costs, Mobil used only the prices received from the Channel Industries contract and ignored the fixed-quantity contracts.

RE-FILING PROVISION

Texaco and Exxon claim the above to be the methods they "actually used" by virtue of resubmitting monthly reports.

Section 212.126(b) of the DOE Mandatory Petroleum Price Regulations (10 C.F.R. § 212.126(b), 39 Fed. Reg. 1961, January 15, 1974) requires that refiners

> . . . shall prepare and file with the FEO periodic reports in accordance with forms and instructions issued by FEO. Each refiner shall submit its calculations under the formulas of § 212.83 in accordance with the forms and instructions issued by FEO.

Forms FEO-96, FEA/DOE P110 and EJA-14 were issued pursuant to this provision. Both forms P110 and FEO-96 contain the question, "Is this a resubmission?" and a box to check either "yes" or "no." Neither the forms nor the regulations define the purpose or scope of the resubmission procecure.[3] The forms provided no time limit for resubmission.

Effective May 1, 1979, the DOE amended § 212.126 to limit refiling to one year after the original filing except where expressly authorized by DOE or where written permission to resubmit or refile is granted for good cause

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[3] Form P110-M-1 Specific Instructions states: "Item (7)—Is this a resubmission? Answer 'Yes' if you are supplying additional information or are resubmitting a report. In either case, the form must be completed in its entirety."

shown. 44 Fed. Reg. 14534, March 13, 1979, 10 C.F.R. § 212.126(d). DOE stated that the purpose of the allocation reports is to assure compliance with § 212.83 (Subpart E).

> "We recognize that these reports sometimes require the use of estimated data and that in dealing with such calculations some good faith errors are unavoidable. However, in order to more effectively stabilize cost allocation data for the pupose of finalizing compliance actions or audits, and to prevent possible circumvention of the regulations by inappropriate use of the resubmission procedure, it is necessary ot issue explicit regulatory provisions regarding the time for refiling cost allocation reports by refiners and the types of revisions which may be made on the forms." 44 Fed. Reg. 14535 March 13, 1979.

Though such language might appear to preclude the use made by Texaco and Exxon of the refiling procedures, the interpretation of the DOE apparently concedes that a resubmission may be made to reflect the refiner's new methodology. When initially proposed, the amendments contained a sixty-day limit on refiling. Comments received in response convinced DOE to allow a full year to refile. One of the criticisms received was that "any increased allowable costs in a prior period due to retroactive DOE interpretations, rulings and clarification and court decisions could not be automatically reported by a unilateral refiling of an amended cost allocation form." Thus, the agency contemplated the use of the resubmission procedure to retroactively adopt a new method.

Further, the FEA stated that "While such resubmissions and refilings will be automatically accepted, the adjusted data submitted will be subject to verification and approval." *Id.*

SUBPARTS E AND K

The Mandatory Petroleum Pricing Regulations basically froze the prices of all refined petroleum products at their May 15, 1973 levels. The regulations specified the permissible price increases. Subpart E applied to the sale of refined products by "refiners."

> § 212.81 Applicability
>
> . . . this subpart applies to each sale of a covered product which is purchased or refined by a refiner.
>
> § 212.82 Price Rule
>
> (a) *Rule.* A refiner may not charge to any class of purchaser a price in excess of the base price of that covered product except to the extent permitted pursuant to the provisions of paragraphs (c) through (k) of this section.
>
> (b) *Price increases.* A price in excess of the base price of an item in a product line may be charged only to recover on a dollar-for-dollar basis *those net increases in allowable costs* that have been incurred with respect to the product line . . . .
>
> (2) . . . 'Allowable costs' under this section means *non-product* costs attributable to refining operations. . . . (emphasis added)

The "base price" is defined in § 212.82(f) as the May 1973 price plus "increased product costs" incurred between the month of measurement and the month of May 1973.[4]

§ 212.83 prescribes the method of computing the base price pursuant to § 212.82(f). This section, however, per-

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[4] The May 1973 ceiling price is the weighted average sales price on May 15, 1973; subsection (f) states that "In computing the base price, a firm may not exclude any temporary special sale, deal or allowances in effect on May 15, 1973." In other words, the regulations warned the refiners not to arbitrarily or unjustifiably maximize their base price calculation.

tains to the pricing of petroleum products produced from *crude* oil, as opposed to natural gas.

> § 212.83 Allocation of refiner's increased product costs.
>
> (b) *Definitions.* For purposes of this section—'cost of petroleum product' means (1) for purposes of domestic petroleum products *other than crude petroleum*, the *purchase price* including transportation costs. . . .
>
> 'Increased product costs' are defined as the increase in the total cost of crude (between the month of measurement and May 1973) *plus* the increase cost of petroleum product.

Under Subpart E, the costs refiners (or processors) were allowed to pass through were based on their actual cost of raw materials and refining operation costs. Where crude oil was a raw material used in producing a refined product, the regulations allowed the price to increase considerably. The price of crude was permitted to rise to this extent because the market price of oil was rising so astronomically.[5]

The price of refined products produced from natural gas, on the other hand, was not allowed to rise as dramatically; rather, they were effectively limited to their May 1973 prices. *See National Helium Corp. v. FEA*, 569 F.2d 1137, 1143 (TECA 1977), *citing* Emergency Amendment to Special Propane Rule, 39 Fed. Reg. 28608. The price of a petroleum product therefore depended in part upon the raw material from which it was produced.

The plaintiffs first argue that, analogizing natural gas to crude oil, their transfer-pricing is a reasonable method under Subpart E.

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[5] It was in fact the oil embargo that led to the mandatory allocation and price control of petroleum products in the first place. The purpose was to keep the prices stable without stifling production.

This court has already found the transfer method unreasonable. (Memorandum Opinion, page 17.) As stated before (and as indicated by the regulations cited above), the intra-firm transfer price was allowed *only* for *imported* crude. Further, the Emergency Amendment to the Special Propane Rule explicitly prohibited the calculation of increased costs of NGLs based on acquisition of natural gas from an affiliated entity. § 212.83(c)(1)(iii). The intra-firm transfer price utilized by Exxon referred to the "posted" price of crude. Though Exxon self-servingly argues that such a reference price results in a parity of pricing between products produced from gas and those produced from crude, the fact is that crude prices were rising while natural gas prices were not. Thus Exxon was attributing increased product costs to NGLs which, contrary to the scheme of Subpart E, had no basis in reality.

Since Subpart E was geared primarily to crude oil refiners, many gas processors were left with 1973 prices. If the processor bought the natural gas he processed, the increased cost based on that *purchase price* could be passed through under Subpart E as an increased product cost. Processors who processed their own natural gas, however, were denied inter-affiliate transfer prices, and could only pass through certain increased costs of production as increased non-product costs. Since they did not purchase raw materials, they incurred no actual increased product costs, but rather were effectively limited to the increased costs of producing the natural gas. Since the cost of producing natural gas did not increase significantly during the E period, their prices were effectively frozen at or near 1973 prices.

The FEA recognized the lack of attention given gas processors in the regulations:

> ". . . while natural gas liquids are subject to the FEA's mandatory price regulations, increased costs associated with the production or processing of nat-

> ural gas liquids have generally been minimal and there has been no precise method for passing any increased costs through in the present regulations. The FEA is aware of the need for improving its regulations in this area and will be proposing amendments for this purpose in the immediate future. In the meantime, the amount of increased product costs which may be passed through by refiners is subject to the general principle that such increased costs are limited to those cost increases which reflect payment of lawful prices." 39 Fed. Reg. 28608, August 9, 1974.

Thus the issue is whether the plaintiffs' "incremental" method was a reasonable one under Subpart E in that it reflected the payment of lawful prices. The FEA permitted the Subpart K shrinkage formula to be applied retroactively to the E period. 40 Fed. Reg. 10824 September 4, 1975. The plaintiffs' incremental method will therefore be discussed in the context of Subpart K, but the reasonability of the method must be judged in terms of the two distinct regulatory premises of Subpart E and Subpart K. This court rejected the plaintiffs' incremental method during the K period in the original Memorandum Opinion. The FEA directly addressed the problem of NGL pricing and the natural gas/crude oil pricing disparity by enacting Subpart K. While Subpart E basically allowed the increased price *paid* by the processor or refiner for the raw material used in processing, Subpart K calculated increased costs based on what the processed gas *would have been sold for* by the processor had it not been lost in the extracting process. Under Subpart K, what the gas *would* have been sold for is measured by the contracts in effect.

Subpart E and Subpart K attack the problem of determining actual increased natural gas (product) costs from two fundamentally different directions. Subpart E sought to base the price of the product on the *cost* of the natural

gas to the processor; Subpart K sought to base the price on the price for which the processor would have *sold* that gas (under existing contracts) had it not been used in processing NGLs.

In that the purpose of the pricing regulations was (1) incentive for production of NGLs (2) minimization of prices, Subpart K's opportunity methodology struck the balance more in favor of the incentive to produce. As set out in the original Memorandum Opinion, the relevant provisions of Subpart K are sections 162 and 167. 10 C.F.R. § 212.162 defines "cost of shrinkage" as:

> [t]he reduction in selling price per thousand cubic feet (MCF) of natural gas processed, which is attributable to the reduction in volume or BTU value of the natural gas resulting from the extraction of natural gas liquids, as determined pursuant to the *contracts in effect at the time* for which cost of natural gas shrinkage is being measured, and under which the *processed* natural gas is *sold.* (emphasis added)

10 C.F.R. § 212.167(b) defines "Increased product costs" as

> (3) the difference between the *weighted average cost* of natural gas shrinkage per thousand cubic feet (MCF) of natural gas processed in the month of May 1973, and the *weighted average cost* of natural gas shrinkage per thousand cubic feet (MCF) of natural gas processed in the current month, multiplied by the number of thousand cubic feet (MCF's) of natural gas processed in the current month. (emphasis added)

As DOE contends, and the court agreed as the proper interpretation, Subpart K requires the processor to weight average *all* contracts in effect—both fixed-quantity and surplus—for the sale of residue gas to calculate the loss resulting from shrinkage. The plaintiffs' incremental

method would exclude the lower-priced fixed-quantity contracts from that weighted average calculation.

With respect to Subpart E, the use of an opportunity cost method which excludes the fixed-quantity price, is unreasonable. Subpart E sought to allow the pass-through of *actual* increased *costs*; the FEA allowed a reasonable method which would, in effect, reflect the payment received by the processor in the sale of the processed gas. The costs at which the processor would have sold the gas used in processing, only reasonably reflects *actual* costs if the fixed-quantity contract price term is included. An essential fact that the plaintiffs refused to concede at the October 25th hearing and glossed-over in their briefs, is that one of the two objectives of the EPAA was the minimization of the price of petroleum products. To use only higher price surplus contract terms in calculating the increase cost of natural gas circumvents price control mandated by Subpart E.

With respect to Subpart K, plaintiffs' incremental method is also unreasonable.[6] The Preamble to Subpart K states that "The cost of shrinkage shall be computed based upon the *contractual terms in effect* for the sale of natural gas *during the time period for which shrinkage cost is being measured.*" 39 Fed. Reg. 44409, December 24, 1974 (emphasis added). Clearly, the exclusion of the fixed-quantity contract price was not contemplated by the regulations, but rather subverts their purpose.

The plaintiffs argue that since there is no loss of revenue resulting from the extraction of NGLs under *satisfied* fixed-quantity contracts, Subpart K contemplates, or at least permits, the exclusion of fixed-quantity contracts. *See e.g.* Exxon's Reply to Defendants' Response, page 4. This argument, however, proves too much. When there are outstanding contracts—fixed-quantity or otherwise—

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[6] Plaintiffs' argument was rejected in the original Memorandum Opinion, pages 5-7.

and a stream of gas enters a plant for processing, part of the BTU content that could conceivably have gone toward satisfaction of those existing contracts is lost. In other words, the loss of revenues from processing actually pertains to *all* the existing contracts. Plaintiffs' theoretical attribution of the loss of revenue due to processing exclusively to surplus contracts is spurious; it is merely a rationalization for charging the highest price possible. Plaintiffs obviously would not realize as much shrinkage loss by using their long-term low price contracts as they would on their more current contract; that is not a phenomenal or unique situation; nor is it a valid excuse to evaide the regulations and exclude fixed-quantity contracts from calculating shrinkage.

Further, plaintiffs argue that the shrinkage calculation should include contracts under which the liquids would have been sold but for processing, but exclude contracts under which the liquids would not have been sold. Fixed-quantity contracts should, according to plaintiffs, therefore be excluded because *no more than the committed quantity would have been sold thereunder* by any rational processor. This argument presumes that the regulations intend to allow processors to recoup increased costs based on prices that could presently be contracted for gas. The fact that Exxon would sell "no more than the committed quantity" is totally irrelevant. Exxon is presumed by the regulations to sell only the fixed amount at that contract price; that is why the average of all such contract prices are *weighted.* The price which Exxon actually received under the fixed-quantity contract, though not a price that Exxon would necessarily contract for at the time of measurement, is none the less relevant for calculating loss of revenues due to shrinkage. The dollar-for-dollar pass through entails actual, not potential, prices.

The plaintiffs finally make a construction argument with respect to Subpart K. Plaintiffs argue that since § 162 does not mention "weighted average", that term,

when used in § 167 pertains only to those situations where one entity operates several gas plants and calculates a single cost of shrinkage. Ruling 1973-18 directly refutes such a strained reading of the regulations:

> The purpose of requiring a 'weighted average' cost comparison is to provide a method by which firms which have chosen, pursuant to § 212.167(b), to aggregate the total amount of increased product costs respecting volumes of natural gas subject to differing sales contracts which are processed in *one* or more plants, may calculate a single amount representing the increased costs of natural gas shrinkage for the aggregate of volumes of natural gas processed. Accordingly, the above formulae provide the acceptable methods for the computation of a 'weighted average cost of natural gas shrinkage.' Where the increased costs associated with several volumes of processed natural gas have been aggregated, the residue price which is used to determine the cost of natural gas shrinkage is a *weighted average of all the contract price terms under which the different volumes of processed natural gas are sold.* Ruling 1975-18, 40 Fed. Reg. at 55863, December 2, 1975 (emphasis added).

Clearly Subpart K should be read as a whole, and should not be arbitrarily segregated into parts which, standing alone, are meaningless.

Mobil, while making the same general argument with respect to the exclusion of the fixed-quantity contract price from the weighted average, also asserts that it should not be judged on the basis of a factual situation different from its own. The regulations in question did not contemplate uniform contractual situations for all gas processors, but rather were premised on the assumption that the contractual situations would be varied. *See* 39 Fed. Reg. 32720, September 10, 1974. The fact that all

of the gas processed at Mobil's Old Ocean plant is under contract does not in any way alter the interpretation of the regulations discussed above.

The court finds that the plaintiffs' "incremental method" was unreasonable under both Subpart E and Subpart K, and that the DOE interpretation is reasonable in light of its purpose.

ARBITRARY AND CAPRICIOUS

All plaintiffs take the position that Subpart K, and the procedure used in promulgating this subpart, constituted arbitrary and capricious action on the part of DOE. The thrust of the argument is that in promulgating Subpart K, DOE failed to take into account the fixed-quantity contracts, and that these contracts are so imperative to the determination of shrinkage costs that the agency's failure to explicitly consider them renders the regulation void under *Motor Vehicle Manufacturers Association of the United States, Inc., v. State Farm Mutual Automobile Insurance Co.*, 51 U.S.L.W. 4953 (U.S. June 24, 1983) (hereinafter "*Airbags*"). In the *Airbags* case, the Supreme Court held the revocation of a safety standard requiring passive restraints in cars arbitrary and capricious. Motor Vehicle Safety Standard 208, promulgated pursuant to the National Traffic and Motor Vehicle Safety Act of 1966, required automobile manufacturers to install either of two passive restraint devices: airbags or seatbelts. The industry planned to comply by installing seatbelts in 99% of the cars produced. *Id.* at 4955. The agency later concluded that the seatbelts would not achieve the anticipated safety results because they could be detached, and completely rescinded the regulation. Since the agency itself had previously determined that airbags would achieve the desired results under the Motor Vehicle Safety Act, the Court held that the rescission of Standard 208 without even considering the airbag option was arbitrary and capricious. *Id.* at 4957, 4958.

When Subpart K was promulgated, however, the DOE considered the analogous relevant factors. As stated in the Preamble, ". . . there is no single ideal solution to the regulation of natural gas liquid prices, and the regulations adopted by the FEA today are a necessary compromise among the conflicting considerations which must be taken into account. . . . [T]he fundamental objective is to permit prices that will be as low as reasonably possible without adversely affecting the availability of the product." 39 Fed. Reg. 4408, December 24, 1974. To achieve this dual-objective, the agency considered several approaches: price ceilings, profit margin limitations, and a flexible price based on varying costs of gas and crude oil. *Id.* These are the crucual considerations. Fixed-quantity contracts are not to Subpart K as airbags are to Standard 208. Fixed-quantity contracts are only one aspect of one of these alternative price control alternatives. The Supreme Court made this clear in *Airbags* by stating that ". . . a court may not impose additional procedural requirements upon an agency . . . Nor do we broadly require an agency to consider all policy alternatives in reaching a decision. It is true that a rulemaking cannot be found wanting simply because the agency failed to include every alternative device and thought conceivable by the mind of man . . . regardless of how uncommon or unknown that alternative may have ben." *Id.* at 4958, *citing Vermont Yankee Nuclear Power Corp. v. NRDC*, 435 U.S. 519 (1977). In this case, the plaintiffs' contention would impose insurmountable requirements upon DOE. Requiring consideration of each specific contract in effect would force executive agencies to foresee every conceivable contingency and would effectively preclude them from rulemaking. The court finds that the agency did not act arbitrarily or capriciously in the promulgation of Subpart K.

ONE-HOUSE VETO

Finally, in a motion for summary judgment, Exxon asserts that the Acts in question, the EPAA and the EPCA, 15 U.S.C. §§ 751, *et seq.*, are invalid because they contained a one-house veto provision, declared unconstitutional by the Supreme Court in *Immigration and Naturalization Service v. Chadha*, —— U.S. ——, 51 U.S.L.W. 4907 (June 23, 1983).[6]

In the *Chadha* case, the statute in question contained a severability clause, thus only the veto provision itself was invalidated. Further in *Chadha*, the veto provision was actually exercised to the detriment of the plaintiff. The Supreme Court emphasized the fact that *exercise* of the veto was a legislative function, and thus violated Article I.[7] In this case, however, no veto has been exercised over the regulations in question. A substantial constitutional question exists as to whether a retained veto provision, though unexercised, falls under the *Chadha* decision. The fact that a district court has held such a retained veto provision unconstitutional makes the issue no less substantial. *EEOC v. Allstate Insurance Co.*, No. J82-0186 (B) (S.D.Miss. September 9, 1983). The far-reaching implications of invalidating statutes which merely contain one-house veto provisions are hardly settled by this Mississippi court opinion. Further, in this case, Congress does not have the power to veto the regulations in question. Whether Exxon has standing to raise the issue is thus closely intertwined with the constitutional ques-

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[6] The veto provisions in the EPAA and EPCA pertained only to certain provisions giving the President decontrol authority.

[7] "Examination of the action taken here by one House pursuant to § 244(c)(2) reveals that it was essentially Legislative in purpose and effect. . . The one-House veto operated in this case to overrule the Attorney General and mandate Chadha's deportation; absent the House action, Chadha would remain in the United States. Congress has *acted* and its action has altered Chadha's status. *Id.* at 4916 (emphasis supplied).

tion. Both the constitutionality of the Acts and the standing question depend on the limits the Supreme Court places upon the *Chadha* decision.

Therefore, pursuant to 12 U.S.C. § 1904 note (§ 211), the substantial constitutional issues raised by Exxon's motion for summary judgment are certified to the Temporary Emergency Court of Appeals.

CONCLUSION

For the reasons stated above, the court finds that:

1. Both the plaintiffs' intra-firm transfer price method and alternative incremental method are unreasonable under Subpart E.

2. DOE's interpretation of Subpart K is reasonable in light of the purpose of Subpart K.

3. The plaintiffs' exclusion of fixed-quantity contracts from the calculation of the weighted-average cost of shrinkage is unreasonable under Subparts E and K. In short, the weighted average cost of shrinkage reflects what processors were receiving under contracts in effect for their processed gas; and under either Subpart E or Subpart K, the exclusion of fixed-quantity contracts overstates what was actually received and is thus contrary to the purposes of the regulations.

4. DOE's promulgation of Subpart K was not arbitrary and capricious.

5. The one-house veto provisions in the EPAA and EPCA present substantial constitutional questions.

6. The court has considered the relevant agency rulings and interpretations and, as discussed in the original Memorandum Opinion, finds that they support rather than refute DOE's position in this case.

7. The material and ultimate facts in this case are not in dispute.

Therefore:

The Motion of Texaco Inc. for a New Trial is denied.

The Motion of Mobil Oil Corporation and Mobil Oil Exploration and Producing Southeast, Inc. for New Trial or in the Alternative for Clarification is denied.

The Motion of Exxon Corporation to Clarify Memorandum Opinion Concerning Subpart E is denied.

The Motion of Exxon Corporation to Vacate Findings of Fact and Conclusions of Law Concerning Subpart K and to Substitute Other Findings of Fact and Conclusions of Law is denied.

The motion of Exxon for Partial Reconsideration in Light of Intervening Supreme Court Opinion and Misapprehension of Parties' Positions is denied.

Exxon's Supplemental Motion for Summary Judgment presents substantial constitutional questions and is certified to the Temporary Emergency Court of Appeals.

In accordance with the Memorandum Opinion issued June 24, 1983, the plaintiff's Motion for Summary Judgment with regard to the ethane exclusion is granted, and the defendants' corresponding motion is denied. The defendant's Motion for Summary Judgment on all other issues is granted, and the plaintiff's motion denied.

The attorneys will confer and submit a judgment in accordance with this order. Such judgment shall include the certification of the constitutional issues to the Temporary Emergency Court of Appeals and shall be submitted to the court for entry on or before December 15, 1983.

The Clerk will furnish a copy hereof to each attorney.

ENTERED this 22nd day of November, 1983.

/s/ Halbert O. Woodward
HALBERT O. WOODWARD,
Chief Judge
Northern District of Texas